HM Revenue & Customs

Annual Report and Accounts 2015-16

Report by the Comptroller and Auditor General

National Audit Office

HM Revenue & Customs 2015-16 Accounts

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Sir Amyas Morse KCB
Comptroller and Auditor General
National Audit Office

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This report provides the findings and overall conclusion of work conducted under section 2 of the Exchequer and Audit Departments Act 1921, by which the Comptroller and Auditor General must consider the adequacy of the systems to assess, collect and allocate tax revenues.

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Contents

Coverage of this report

HMRC corporate document	Coverage of this report
Trust Statement	HM Revenue & Customs (HMRC) reported £536.8 billion of tax revenue for 2015-16. We cover this in Part One. Under the Exchequer and Audit Departments Act 1921, the Comptroller and Auditor General (C&AG) must certify whether the Trust Statement is true and fair, and whether HMRC has used the income and expenditure for the purposes Parliament intended. The C&AG has concluded that: • the figures in the Trust Statement are true and fair; and • HMRC has used income and expenditure for purposes Parliament intended. The 1921 Act also requires the C&AG to consider whether HMRC's revenue systems to collect taxes are adequate. We found that HMRC's revenue systems are adequate subject to the observations in this report and our other reports to Parliament (Paragraphs 34 to 36).
Resource Accounts	The annual cost of running HMRC was £3.2 billion in 2015-16. HMRC paid £39.9 billion in benefits and credits, including £28.2 billion of Personal Tax Credits payments and £11.7 billion of Child Benefit. Under the Government Resources and Accounts Act 2000, the C&AG must certify whether HMRC's Resource Accounts are true and fair, and whether HMRC has used the income and expenditure for the purposes Parliament intended. The C&AG: • found the Resource Accounts are true and fair; but • found material levels of error and fraud in Personal Tax Credits expenditure (Part Four).
Annual Report	HMRC reported £26.6 billion compliance yield in 2015-16. We reviewed compliance yield data with the agreement of HMRC. Our conclusions about compliance yield are in Part One. We review whether HMRC is getting value for money. We report our findings to Parliament under section 6 and section 9 of the National Audit Act 1983. We refer to our recent work on value for money in this report.

Summary

HM Revenue & Customs’ performance, 2015-16

1 This report is our commentary on HM Revenue and Customs’ (HMRC’s) performance in 2015-16. We report findings from all our statutory audits of HMRC this year including audits of HMRC’s financial statements, the adequacy of its systems for collecting revenue and the value for money it achieved from its spending. Each audit comes under different legislation (see Coverage of this report, page R4).

2 Our audit of HMRC covers the tax revenues the government raises and the benefits HMRC pays out. HMRC raised £536.8 billion of tax revenues this year (some 80% of total revenues raised by government) and paid out £40 billion in benefits and credits (approximately one-fifth of the government’s total benefit expenditure). The annual cost of running HMRC, which is the second-largest government department in terms of staff numbers, was £3.2 billion in 2015-16.

3 Each year, we choose parts of HMRC’s business to report on in more detail. Last year’s report considered: how HMRC measures compliance yield; its assessment of the tax gap and tax risk; and its plans for tax administration.

4 This year’s report has four parts:

- Part One considers HMRC’s objective of maximising revenues and looks at the main components of the £536.8 billion raised during 2015-16 and the robustness of HMRC’s estimate of £26.6 billion in compliance yield, the additional revenues it has generated through its compliance and enforcement activities;
- Part Two looks at HMRC’s progress in transforming the way it administers taxation;
- Part Three considers how well HMRC manages tax reliefs; and
- Part Four examines progress in managing fraud, error and debt in Personal Tax Credits and Child Benefit and explains the basis of the Comptroller and Auditor General’s qualification of his regularity audit opinion on HMRC’s Resource Accounts.

Summary findings

5 HMRC's vision, as published in its *Single Departmental Plan*, is as follows: "We are the UK's tax, payments and customs authority, and we have a vital purpose: we collect the money that pays for the UK's public services and help families and individuals with targeted financial support. We do this by being impartial and increasingly effective and efficient in our administration. We help the honest majority to get their tax right and make it hard for the dishonest minority to cheat the system."[1]

Tax revenues and spending in 2015-16

6 The Trust Statement reports that HMRC's total revenue was £536.8 billion in 2015-16, an increase of £19.1 billion (3.7%) on 2014-15. HMRC records revenues in the Trust Statement on an accruals basis (tax due rather than actual cash received). Cash receipts in 2015-16 were £530.0 billion (£513.1 billion in 2014-15) (paragraphs 1.3 and 1.4).

7 HMRC increased its spending on administration from £3.1 billion in 2014-15 to £3.2 billion in 2015-16 (3.2%). Its ratio of revenue collected per £1 of administrative expenditure rose slightly from £166.95 in 2014-15 to £167.06 in 2015-16 (paragraph 1.19).

8 Compliance yield measures the effectiveness of HMRC's compliance and enforcement activities. It is one of HMRC's main performance measures and is used to agree targets with HM Treasury for spending on compliance work (paragraph 1.23).

9 HMRC's estimate of compliance yield in 2015-16 was £26.6 billion, against a target of £26.3 billion. HMRC achieved the same amount of yield in 2014-15 against a target of £26.0 billion (paragraph 1.26).

10 Compliance yield gives HMRC a reasonable proxy for assessing the impact of its individual interventions and to support internal decisions about how to allocate resources. HMRC's methodology for measuring yield is adequate and our work has provided evidence that HMRC has effective processes in place to collate data and ensure quality. Where these processes uncover errors or gaps in supporting documentation, HMRC works to address these (paragraphs 1.34 to 1.41).

11 As a publicly reported measure, it is important that readers of HMRC's Annual Report are clear that compliance yield is not simply a cash figure. The compliance yield calculation draws on a range of different measures of revenue generated or losses prevented, all of which involve a degree of estimation and uncertainty. Also, the compliance yield total does not equate to revenues received during the year arising from HMRC's enforcement and compliance activities. HMRC has continued to improve the transparency of its reporting to clarify that compliance yield is not simply a cash figure (paragraphs 1.30 to 1.32, 1.39 and 1.40).

1 HM Revenue & Customs, *Single Departmental Plan 2015 to 2020*, updated May 2016.

12 Building on our previous recommendations and those of the Committee of Public Accounts, **we recommend that HMRC:**

- undertakes research to consider whether its initial estimates of yield subsequently turn out to be accurate. Such checks would help to validate the amount of yield HMRC reports and support assertions that taxpayers had been more compliant due to their changed behaviour; and
- building on this research, uses the results to provide further explanation, for example in HMRC's Annual Report, about the inherent uncertainty associated with reported compliance yield. This would help to better inform readers of the estimations and assumptions that underlie HMRC's reporting of its performance.

Transforming tax administration

13 HMRC has stated that its vision is to have "one of the most digitally advanced tax administrations in the world". To achieve this aim, HMRC will be managing a complicated transformation over the next five years. It will make significant changes to a number of different areas of the organisation, with a number of the changes being dependent on others. HMRC has a strong rationale for its plans to use technology to modernise its services and reduce its costs which are closely aligned with the Department's strategic objectives. But we have commented in previous reports that they carry significant delivery risk. Success will depend on taxpayers choosing to use the new online services. HMRC will need to build public trust that the new digital systems are easy to use and secure (paragraphs 2.3 to 2.6).

14 When we reported last year, HMRC's plans were at an early stage. It was clear then that this transformation would be more complex and far-reaching than previous change programmes, and we said we would report on progress as the programme developed. Since our review last year, HMRC has (paragraph 2.7):

- made plans to spend more than £2 billion to achieve its vision over the next five years;
- agreed with HM Treasury the high-level outcomes it will achieve over the next four years and secured £1.3 billion of new investment funding to support the transformation over that period;
- launched digital tax accounts for individuals. HMRC has reported that more than one million customers had used the new accounts by April 2016;
- announced its plans to close 137 offices (90% of its locations) and the location of its 13 new regional hubs where almost all its staff will be based within the next ten years; and
- secured ministerial and supplier agreement for its plans to replace its IT services contract, Aspire, which it has revised to reduce the risk of carrying out too much change too quickly.

15 There is no single right answer about how a change programme of this magnitude should be managed. HMRC's approach looks credible and proportionate to the scale of the risks involved, and it has worked closely with HM Treasury and Cabinet Office to develop and refine its plans. It is too early to evaluate how well its approach is working, but HMRC needs to maintain a clear view of whether it is on track to achieve its strategic goals, monitoring its progress against a robust set of interim milestones. In such an extensive change programme, it would be easy for HMRC to lose sight of progress towards its vision through small changes to the timing or scope of projects which are mutually dependent. It has put in place a rolling programme of business planning and governance, seeking to learn and apply the lessons from its experience as projects mature. 2016-17 is the year of greatest activity in terms of both spending and the benefits HMRC expects to achieve from transformation. It will therefore be particularly important early in 2017-18 for HMRC to take stock of its progress, learn lessons and refresh its plans as necessary (paragraphs 2.13 to 2.15).

16 With such high levels of change we would expect any organisation to experience occasional setbacks and implementation difficulties, alongside the successes, as it designs and launches new services. When this has happened in the past, such as when HMRC created a national PAYE system, HMRC did not lose sight of its long-term objective and committed serious effort to stabilising the system and tackling a significant backlog of unresolved cases. As we said a year ago, HMRC will need such commitment and resilience if it is not to be deflected from delivering its strategic vision. One of the most critical tests of HMRC's approach will be how management responds when things do not go as expected (paragraph 2.16). We raise two areas of risk at this early stage:

- **Optimism bias in main assumptions:** HMRC's past experience demonstrates that there are serious risks should main assumptions underpinning its strategy not prove realistic. For example, the delivery of HMRC's vision relies on the critical assumption that taxpayers will move over to online services and reduce the demand for telephone and postal services. Our report on the Quality of Service for Personal Taxpayers described how in the last parliament HMRC misjudged the cumulative impact of the changes it was making and released customer service staff before it had reduced the demand from personal taxpayers for its telephone helpline. This impaired the quality of its service to personal taxpayers in 2014-15 and the first half of 2015-16, which then recovered following a range of interventions, including the recruitment of additional staff. HMRC has adjusted its future resource plans in light of this experience, and is now monitoring closely the way taxpayers respond to changes in the way services are provided (paragraph 2.19).

- **Understanding the costs and benefits to taxpayers:** HMRC has not yet estimated the costs for individual taxpayers or businesses of making the transition to online services, or sought to quantify the benefits they can expect. Most business customers will be required to update HMRC quarterly rather than annually about their tax affairs, and some may need to purchase new software that works with the new systems. Based on our consultation with stakeholder groups, we found that some businesses are sceptical of HMRC's evaluations of the costs and benefits of previous changes to the tax system.[2] HMRC plans to develop a fuller picture of what it will cost taxpayers and businesses to use the new systems over the next year (paragraph 2.20).

17 HMRC faces a challenge in being transparent about its plans, and could do more to help the public and Parliament understand what it is doing and where there is uncertainty. At this early stage, it is inevitable that HMRC's plans should contain uncertainty about exactly what will be delivered, by when and at what cost. It is using shorter-term milestones to monitor its progress, agreeing spending plans and performance targets with HM Treasury annually so that it can learn from experience and alter its plans as things change. This is a realistic and prudent approach, given the scale of what HMRC is doing and the inevitability that not everything will go according to plan (paragraphs 2.9, 2.21 and 2.22).

18 In managing change going forward, HMRC should prioritise:

- establishing leading indicators which will provide early warnings if progress is not as expected, and be prepared to adapt its plans when performance is not as expected; and
- developing its understanding of how projects rely on each other, so it can test how any changes will affect the expected costs and benefits of transformation to all its customers.

19 To ensure full accountability and transparency, we would expect HMRC to:

- continue to publish clear information about what it is spending on its transformation and what it expects to deliver, updating its plans and estimates of costs and benefits as things change; and
- make and publish its assessments of the expected costs and benefits of transformation to both individual taxpayers and businesses.

2 Comptroller and Auditor General, *The quality of service for personal taxpayers*, Session 2016-17, HC 17, National Audit Office, May 2016.

Tax reliefs

20 Tax reliefs are integral to the tax system and an important tool for public policy, covering many areas of government activity. Since they reduce the amount of tax payable or generate a payment, they can be the focus of tax avoidance. In 2014, we reported twice on tax reliefs, highlighting the need for greater transparency about the costs and use of reliefs.[3] The Committee of Public Accounts concluded that HMRC needed to improve how it monitors and reports on tax reliefs.[4] In response to these recommendations, HMRC has made progress in addressing gaps in its management of reliefs:

- **HMRC has developed guidelines for managing tax reliefs based on a review of its existing practices.** These guidelines identify principles which, if implemented, would be an important step in improving the management of reliefs across HMRC. The guidelines recommend many aspects of good practice already used by HMRC, such as requiring new reliefs to be risk-assessed and reviewed regularly. While there is no international consensus among tax authorities on the way tax reliefs should be managed, HMRC's guidelines do not draw on wider analysis by the National Audit Office (NAO) or the Organisation for Economic Co-operation and Development (OECD) which identifies a wider range of approaches used by other countries (paragraphs 3.7 to 3.11).
- **It was unclear among those we spoke to that the guidelines were compulsory and no one is responsible for overseeing their implementation.** We recognise new guidance takes time to implement, but no team in HMRC had acted on the guidelines to develop a comprehensive list of the tax reliefs in each area. We looked at a sample of six tax reliefs affecting companies and individuals. While most of the teams managing these reliefs could demonstrate examples of good practice, none planned to change its approach to respond to the new guidelines (paragraphs 3.12 to 3.17).
- **We found examples of good practice in how HMRC monitors the cost of reliefs and responds to unexpected changes.** Some of the reliefs supporting economic growth were managed by specialist units, which checked claims and monitored costs over time. This meant HMRC was better able to detect unusual changes in the costs of these reliefs, look into them and respond appropriately. For example, the venture capital trusts team had identified that costs were increasing, found that companies were using the relief for low-risk investments, which did not meet the policy aim, and recommended changes to legislation (paragraphs 3.18 to 3.22).

3 Comptroller and Auditor General, *Tax reliefs*, Session 2013-14, HC 1256, National Audit Office, April 2014, and Comptroller and Auditor General, *The effective administration of tax reliefs*, Session 2014-15, HC 785, National Audit Office, November 2014.

4 HC Committee of Public Accounts, *The effective administration of tax reliefs*, Forty-ninth Report of Session 2014-15, HC 892, House of Commons, March 2015.

21 HMRC has committed to improving its reporting on tax reliefs, but still provides limited information about their cost and impact. In response to the Committee of Public Accounts' recommendations, HMRC expanded its annual publication of tax reliefs in December 2015. The publication now covers four years of cost data and includes some commentary on variances. However, HMRC's publication of 392 reliefs is shorter than the Office of Tax Simplification's list of 1,100 and excludes some reliefs which are significant in scale. It also excludes some significant corporation tax reliefs, such as group relief, which are published separately. While HMRC also publishes evaluations of some of the tax reliefs on its list, it does make this clear in its annual publication (paragraphs 3.29 to 3.33).

22 We consider HMRC's monitoring of tax reliefs is not yet systematic or proportionate to their value or the risks they carry. Reliefs reduce tax bills and may be exploited or used in ways which Parliament did not intend. With hundreds of reliefs to manage and reducing resources, HMRC must identify which reliefs need the most scrutiny according to risk. We compared the level of management and the cost of each relief in our sample. We found that HMRC closely manages some low-value reliefs for businesses. It does not always do so for higher-value personal tax reliefs, such as principal private residence relief, worth £18 billion in 2015-16. The cost of a relief is only one dimension of the risk to tax revenue and there may be good reasons to treat such reliefs differently. But HMRC could not show us that it had a consistent approach to assessing the degree of risk that each relief carries (paragraphs 3.23 to 3.28).

23 HMRC has committed to adopting best practice in the design, monitoring and evaluation of tax reliefs. It has made some improvements, but it could do more. **We recommend HMRC should:**

- **make clear that its good practice guidance for administering tax reliefs is compulsory.** In particular, all product and process owners should draw up a comprehensive list of reliefs and assess the associated risks. This will help HMRC check that oversight for each relief is suitable;
- **consider how best to provide a central role to oversee the management of tax reliefs.** This role should include further developing guidance and checking it is used appropriately across reliefs;
- **help its teams to make informed decisions about how each relief should be managed.** HMRC's guidance should set out how to decide the best approach to the administration of each relief, including advice on how to assess the risks they carry; and
- **publish all its information on the cost and impact of tax reliefs, including corporation tax reliefs, in a way which makes it more accessible.** To help Parliament understand whether they are working as intended, HMRC should include links to evaluations of tax reliefs where these have been published separately. HMRC should also seek to improve transparency by publishing its internal evaluations of tax reliefs unless there are good reasons not to.

Progress in reducing fraud and error in Tax Credits and Child Benefit

24 **The Comptroller and Auditor General has qualified his regularity audit opinion on the 2015-16 Resource Accounts because of material levels of fraud and error in the payments of Personal Tax Credits.** HMRC's central estimate of error and fraud resulting in overpayments in 2014-15 is 4.8% of total spending on Personal Tax Credits (4.7% in 2013-14) and its estimate of error resulting in underpayments is 0.7% of total spending on Personal Tax Credits. This equates to overpayments of £1.37 billion and underpayments of £0.19 billion. These estimates of error and fraud are the most recent available (paragraphs 4.8 to 4.11).

25 **HMRC has maintained the levels of error and fraud within Personal Tax Credits following the significant reductions achieved in previous years.** It has achieved this by designing and implementing interventions that enable it to identify and target high-risk cases. HMRC analysis shows that during 2014-15 it continued to reduce losses caused by children being incorrectly included in claims and by undeclared partners. However, HMRC's most recent analysis suggests it has not continued to reduce losses in other categories, particularly relating to earnings. The Department should continue to use its analysis of losses within risk categories to inform where best to focus intervention activity (paragraphs 4.9 to 4.17).

26 **HMRC will face further challenges in administering tax credits as claimants transfer to Universal Credit.** Uncertainties in the migration to Universal Credit will leave HMRC managing a diminishing but proportionally more complex caseload, with a reducing and potentially less stable workforce as staff transfer to the Department for Work & Pensions (DWP). In managing the transition, HMRC and DWP should work together to ensure that relevant lessons learned from the error and fraud response on tax credits, and particularly those on household composition (undeclared partner), are maintained under Universal Credit (paragraphs 4.26 to 4.30).

27 **HMRC estimates that overpayment of Child Benefit due to error and fraud was £170 million in 2015-16, equivalent to 1.4% of total spending on Child Benefit.** The vast majority of the estimated error and fraud in Child Benefit relates to customers not replying to requests for information during testing and who HMRC assumes to be non-compliant. HMRC is carrying out additional work to better understand the reasons for non-responses and believes this work is likely to reduce the estimate of error and fraud in Child Benefit. HMRC should develop a more rigorous approach to its testing and evaluation of error and fraud in Child Benefit to identify the true level of losses, the root causes of these and to identify the appropriate actions to reduce error and fraud (paragraphs 4.32 to 4.35).

Summary of findings from our value-for-money work

28 We published three value-for-money reports on HMRC in the past year: on fraud and error in benefits and tax credits; on tax evasion, the hidden economy and criminal attacks; and on customer service for personal taxpayers. We also produced a memorandum for the Committee of Public Accounts on HMRC's progress in replacing its major contract for IT services and a briefing on HMRC's role in enforcing compliance with the National Minimum Wage.[5]

Fraud and error stocktake

29 The government continues to lose large amounts of money because of error and fraud overpayments in welfare benefits and Personal Tax Credits and households continue to not get the support they are entitled to due to underpayments in benefits and Personal Tax Credits. Our stocktake report provided an overview of what HMRC is doing to tackle this problem. We found that HMRC's progress in reducing error and fraud was encouraging, although in October 2015 the Committee of Public Accounts said high levels of benefits and Personal Tax Credits error and fraud remained unacceptable. Part Four provides a further update since our stocktake and updated statistics on error and fraud in Personal Tax Credits and Child Benefit. Appendix Two notes HMRC's response to the Committee's recommendations and our assessment of progress against these recommendations.

Tax evasion, the hidden economy and criminal attacks

30 Our report described the risks to tax collection posed by the three main dimensions of tax fraud and how HMRC responds. HMRC estimates that losses to tax fraud amount to £16 billion each year, nearly half its estimate of the overall tax gap. We concluded that HMRC had started to take a more strategic view of its response to these risks, but needed to go further. It had begun to shift the balance of its work, placing increasing emphasis on measures to prevent non-compliance rather than relying so much on investigating it afterwards. HMRC was also working to improve the way it collects and analyses data. Alongside these positive steps, we encouraged HMRC to do more to strengthen the evidence that underpins its decisions. In April 2016, the Committee of Public Accounts said that HMRC's strategy for tackling tax fraud and its approach to prosecutions was unclear. It also recommended that HMRC should explain why the amount of tax it claims to have recovered from its compliance work rises sharply each year, but the size of the tax gap stays the same.

5 Comptroller and Auditor General, *Fraud and error stocktake*, Session 2015-16, HC 267, National Audit Office, July 2015; Comptroller and Auditor General, *Tackling tax fraud: How HMRC responds to tax evasion, the hidden economy and criminal attacks*, Session 2015-16, HC 610, National Audit Office, December 2015; Comptroller and Auditor General, *The quality of service for personal taxpayers*, Session 2016-17, HC 17, National Audit Office, May 2016; Comptroller and Auditor General, *Replacing the Aspire contract*, Session 2016-17, National Audit Office, June 2016; Comptroller and Auditor General, *Ensuring employers comply with National Minimum Wage regulations*, Session 2015-16, HC 889, National Audit Office, May 2016.

Quality of service for personal taxpayers

31 HMRC's strategy is to make technological improvements, such as increased automation and better online services, which will bring efficiencies and transform tax administration. Its plans in the last Parliament were to cut costs significantly over the past two years by reducing the number of staff in its personal tax teams as it moved demand from traditional services to digital transactions. We found that HMRC had maintained or improved customer service until the end of 2013-14, but then released staff before it had made all the changes needed to reduce demand. As a result, HMRC lived within its budget but saw the quality of its service to personal taxpayers collapse in 2014-15 and the first half of 2015-16. HMRC has since recovered service levels.

Replacing the Aspire contract

32 We provided the Committee of Public Accounts with a memorandum in June 2016 to update it on HMRC's progress in replacing its major contract for IT services, known as Aspire. HMRC is replacing the contract in phases, which it believes reduces the technical and operational risk and gives it the continuity it needs to transform its services while protecting tax revenue and customer service. The first phase commenced in 2015 and the last phase of the replacement is now due to be completed in 2020. We found that HMRC had taken some important steps forward since January 2015: taking over the contractual management of the two main subcontractors; agreeing to bring some services in-house before the contract end in June 2017, while extending some services beyond that date and re-procuring others; transferring a first tranche of more than 200 supplier staff and contractors to a newly created government company; and making 18 of 20 planned appointments to senior IT posts.

Employer compliance with the National Minimum Wage regulations

33 We examined HMRC's investigation of complaints about non-compliance with National Minimum Wage regulations. Since the government began enforcing the National Minimum Wage in April 1999, HMRC identified £68 million in arrears for more than 313,000 workers. With extra resources, HMRC had significantly reduced the average time taken to investigate complaints, to 82 calendar days in 2014-15. However, some complainants still had to wait more than 240 days to get their case resolved.

Conclusion

34 In fulfilling our statutory duties under the Exchequer and Audit Departments Act 1921, while recognising that no tax collection system can ensure that everyone meets their tax obligations, we conclude that in 2015-16 HMRC had framed adequate regulations and procedures to secure an effective check on the assessment, collection and proper allocation of revenue, and that they are being duly carried out. This assurance is subject to the observations on specific aspects of the administration of taxes in this report and our other reports to Parliament.

35 Foremost among these observations from our work in the past year is the need for HMRC to preserve adequate levels of customer service (paragraph 31). HMRC has a strong rationale for its plans to use digitally enabled information to improve efficiency and deliver services in new ways. HMRC will need to move forward carefully, managing the risks associated with this strategy, if it is to maintain adequate service levels, keep down the costs to its customers and protect tax revenue. We also believe that, while HMRC has acted positively to identify and disseminate good practice in the way it administers tax reliefs, a more systematic and structured approach is necessary before it can have confidence that its management of reliefs is proportionate to the risks they carry (paragraphs 20 to 23).

36 In addition to our statutory duties under the Exchequer and Audit Departments Act 1921, the Comptroller and Auditor General has again qualified his regularity opinion on the Resource Accounts due to material levels of error and fraud in Personal Tax Credits. Although error and fraud have fallen since HMRC's changes in approach in 2009 and 2012 to the most recent central estimate of 4.8% for 2014-15, HMRC must continue its work to understand the reasons for the levels of loss. It must refine its interventions to reduce error and fraud, across Personal Tax Credits and Child Benefit. The migration of Personal Tax Credits to Universal Credit will bring further challenges to responding to error and fraud, and HMRC's response will need to develop as migration continues.

Part One

Performance in 2015-16

1.1 HM Revenue & Customs' (HMRC's) objectives for 2015-16 were to:

- maximise revenues;
- make sustainable cost savings; and
- improve the service that it gives its customers.[6]

1.2 This part considers HMRC's performance against the first of these objectives. This is measured by the revenues reported in HMRC's Trust Statement, and by compliance yield, which is disclosed in its Annual Report. This part also considers briefly the second objective based on HMRC's Resource Accounts. We examine the administration of HMRC in more detail in Part Two. We published a separate report on aspects of HMRC's customer service, the third objective, in May 2016.[7]

Revenues in 2015-16

Tax revenue

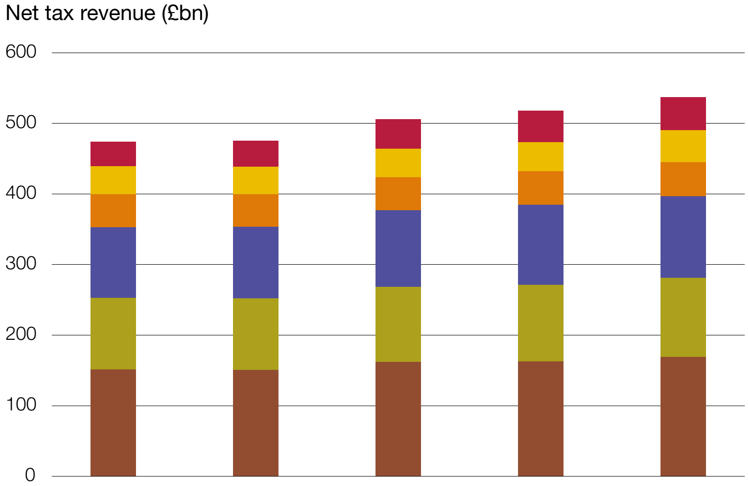
1.3 The total revenue HMRC reported in its Trust Statement in 2015-16 was £536.8 billion (£517.7 billion in 2014-15). HMRC prepares the Trust Statement on an accruals basis. This means that the revenue figure reported relates to tax due on earned income or activities during the financial year, regardless of when the cash is received. In 2015-16, HMRC received £530.0 billion in cash (£513.1 billion in 2014-15), net of cash repayments of £105.9 billion (£97.7 billion in 2014-15).[8]

1.4 The revenue of £536.8 billion (**Figure 1**) was 3.7% greater compared with 2014-15. The taxes that contributed to most of this increase were Income Tax and National Insurance Contributions, which together increased by £10.3 billion (3.8%); Corporation Tax, which increased by £4.1 billion (9.9%); and VAT, which increased by £2.1 billion (1.8%) (Figure 1). Capital Gains Tax and Insurance Premium Tax also recorded significant increases, by 28.1% (to £7.3 billion); and 27.6% (to £3.7 billion) respectively.

6 HM Revenue & Customs, *Business Plan 2014–2016*, April 2014.
7 Comptroller and Auditor General, *The quality of service for personal taxpayers*, Session 2016-17, HC 17, National Audit Office, May 2016.
8 National Audit Office analysis of HM Revenue & Customs' data.

Figure 1
Tax revenues 2011-12 to 2015-16

Total tax revenue has increased in each of the past 5 years



	2011-12	2012-13	2013-14	2014-15	2015-16
Other	34.2	36.5	41.6	44.1	46.4
Corporation Tax	40.1	39.2	40.3	41.4	45.5
Excise Duties	46.9	46.3	46.9	47.2	47.5
VAT	99.6	101.0	108.2	113.9	116.0
National Insurance Contributions	101.6	101.7	106.7	108.0	112.0
Income Tax	151.8	150.9	162.1	163.1	169.4
Total revenue	**474.2**	**475.6**	**505.8**	**517.7**	**536.8**

Source: HM Revenue & Customs' Trust Statements 2011-12 to 2015-16

Repayments

1.5 The total revenue figure of £536.8 billion is made up of gross revenues of £642.3 billion (£614.6 billion in 2014-15) and £105.5 billion of repayments to taxpayers (£96.9 billion in 2014-15).

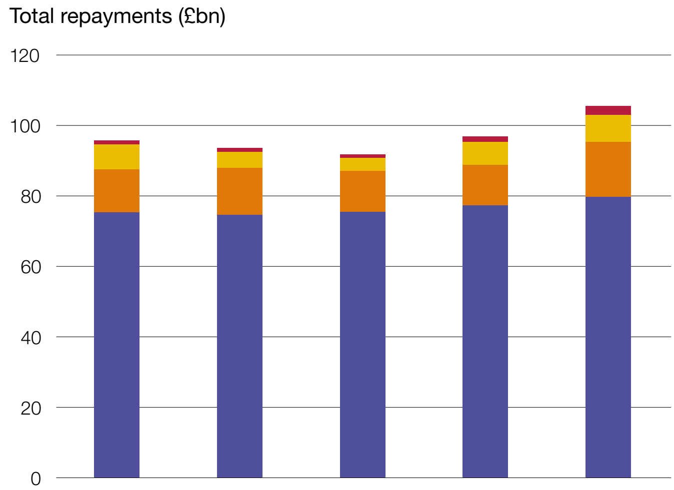
1.6 HMRC receives the gross tax collectable and then repays those taxpayers whose tax liability is less than the tax they paid directly or via a third party. Of the repayments made in 2015-16, £79.9 billion (75.7%) related to VAT (**Figure 2** overleaf).[9]

9 Note 2.2 to the Trust Statement.

1.7 Repayments are a necessary part of tax administration and can arise for a variety of reasons. For certain tax streams, primarily VAT, repayments are an integral part of the system and can be claimed on certain expenditure. In some tax streams, tax may be paid in advance and an adjustment later required when HMRC formally assesses the liability. Some repayments relate to tax received in previous years which is later found to have been assessed incorrectly. Income Tax repayments are common, for example, where taxpayers are given a temporary basic rate tax code which leads to them paying too much tax.

Figure 2
Repayments by tax type 2011-12 to 2015-16

Repayments are a necessary part of tax administration



	2011-12	2012-13	2013-14	2014-15	2015-16
Other	1.1	1.1	1.0	1.4	2.4
Corporation Tax	7.0	4.6	3.8	6.6	7.7
Income Tax/National Insurance Contributions	12.3	13.2	11.5	11.5	15.5
VAT	75.3	74.7	75.6	77.4	79.9
Total revenue	**95.7**	**93.6**	**91.9**	**96.9**	**105.5**

Source: HM Revenue & Customs' Trust Statements 2011-12 to 2015-16

Payments to other government departments

1.8 Some of the total revenue of £536.8 billion is collected on behalf of other government departments with the remaining receipts paid over to the Consolidated Fund. National Insurance Contributions of £112.0 billion (£108.0 billion in 2014-15) were collected on behalf of the National Insurance Fund and National Health Services, student loan repayments of £1.9 billion (£1.8 billion in 2014-15) were collected on behalf of the Department for Business, Innovation & Skills. Revenue of £30.9 billion (£31.5 billion in 2014-15) was transferred to HMRC's Resource Accounts to fund tax credits.

1.9 After taking these into account, together with HMRC's losses, impairments and movements in provisions (£2.4 billion (2014-15: £12.7 billion)), the net revenue of £389.9 billion (2014-15: £364.0 billion) was transferred to the Consolidated Fund. This is the government's current account, which is used to fund its chosen spending plans for the year. HMRC contributes around 88% of the total receipts recorded in the Consolidated Fund (excluding National Loans Fund receipts and repayments from the Contingencies Fund).

Debt and impairment

1.10 Of the total tax revenue of £536.8 billion (2014-15: £517.7 billion), HMRC had not yet received £122.4 billion – 22.8% of revenue (2014-15: £115.7 billion, 22.3%). This consisted of:

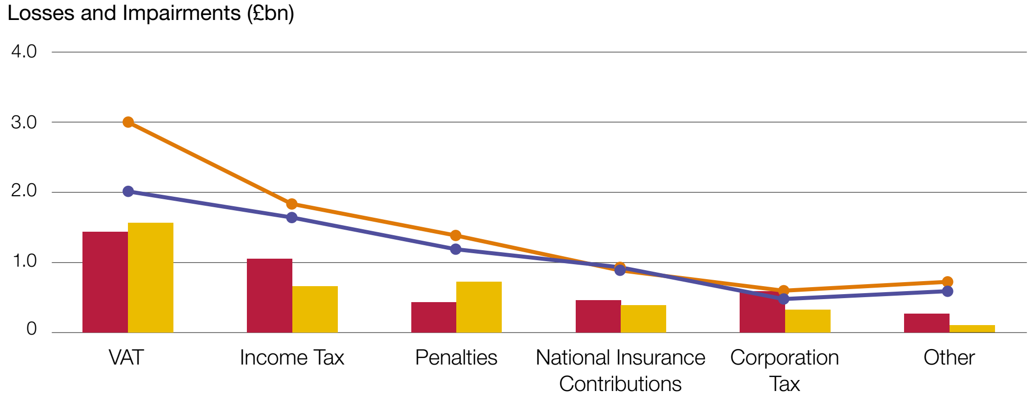
- £26.7 billion (2014-15: £26.0 billion) due from taxpayers but not yet received (receivables); and
- £95.7 billion (2014-15: £89.7 billion) of taxes not yet due from taxpayers, but earned in the financial year (accrued revenue receivable).[10]

1.11 The £26.7 billion of receivables is where taxpayers have yet to make a payment but have a liability to pay at the end of the financial year. However, there is a risk that some of this revenue owed will not be collected or may prove not to be due. Accounting standards require that the Trust Statement reflects this risk. As a result, HMRC has estimated that it may not be able to collect £6.9 billion (2014-15: £8.5 billion) of these receivables. This impairs the overall receivables balance due from taxpayers to £19.8 billion (2014-15: £17.5 billion).[11] This impairment does not mean that HMRC will not collect these amounts, but reflects that there is a chance that it may not. The degree of impairment varies across taxes. VAT and Income Tax carry the highest risks, which include VAT liabilities being uncollectable because of company insolvencies (**Figure 3** overleaf).

10 Note 4 to the Trust Statement.
11 Note 4.1 to the Trust Statement.

Figure 3
Impairments and revenue losses 2015-16

VAT and income tax carry the highest risk that tax will not be collected



	VAT	Income Tax	Penalties	National Insurance Contributions	Corporation Tax	Other
Losses 2014-15	1.4	1.0	0.4	0.5	0.6	0.3
Losses 2015-16	1.6	0.7	0.7	0.4	0.3	0.1
Impairments 2014-15	3.0	1.9	1.4	0.9	0.6	0.7
Impairments 2015-16	2.0	1.7	1.2	0.9	0.5	0.6

Source: National Audit Office analysis of HM Revenue & Customs data

1.12 The £26.7 billion of tax owed at 31 March 2016 includes £13.0 billion of overdue, collectable and enforceable tax debt (£13.0 billion at 31 March 2015). During 2015-16, HMRC managed a total of £55.7 billion of new tax debt, which was £1.6 billion less than in the previous year. HMRC also collected £42.7 billion (£40.5 billion in 2014-15). These figures exclude values related to tax credit receivables, debt and cash collection, which are now accounted for in HMRC's Resource Accounts.[12]

Revenue losses

1.13 Receivables that have been impaired may still be collected, but in some cases HMRC assesses that the tax is unlikely to be collected. When this happens it is either written off, where there is no practical way to pursue it, or it is remitted, where HMRC decides not to pursue a tax liability on value-for-money or hardship grounds.

1.14 Revenue losses of £3.8 billion have been recognised in the 2015-16 Trust Statement (Figure 3). This total comprises £3.2 billion of write-offs and £0.6 billion of remissions. This represents a decrease of £0.4 billion in revenue losses from 2014-15. The most significant reductions in revenue losses were for Income Tax and National Insurance Contributions (£0.5 billion decrease in revenue losses), and Corporation Tax (£0.3 billion decrease in revenue losses). Both Fines & Penalties and VAT revenue losses increased in 2015-16, by £0.3 billion and £0.2 billion respectively. The main reasons for high-value (more than £10 million) tax revenue losses occurring are disclosed in Note 4.4 of the Trust Statement.

12 National Audit Office analysis of HM Revenue & Customs data.

Provisions and contingent liabilities

1.15 HMRC recognises a provision in the Trust Statement where it considers it probable that it will need to repay taxes already paid to it in this and previous financial years. HMRC includes two categories of such probable repayments:[13]

- **Legal claims** where taxpayers have disputed the interpretation of legislation through the courts and want the tax payable to be reassessed. The outcome depends on the court ruling. But as at 31 March 2016 HMRC expects it will have to repay £5.9 billion (2014-15: £7.2 billion). In 2015-16, HMRC made repayments of some £1.9 billion with respect to legal provisions.

  HMRC also separately discloses contingent liabilities for legal claims, where it considers that it is possible that it will be required to repay tax. Contingent liabilities increased by 37.9% to £49.1 billion at 31 March 2016 (2014-15: £35.6 billion) largely because HMRC revised its previous estimates of the calculation of interest that may need to be paid for those cases that make up the contingent liability balance.

- **Oil field decommissioning costs** where companies offset the costs of decommissioning oil and gas fields in the North Sea against tax they have previously paid on those fields. These costs can be carried back to earlier years indefinitely, in contrast to other taxes that are time-limited. HMRC has estimated that it will have to repay £6.9 billion as at 31 March 2016 (2014-15: £7.5 billion). In 2015-16, HMRC repaid £0.2 billion of Petroleum Revenue Tax (PRT) with respect to this liability.

  Included within the £105.5 billion repayments (Figure 2) is a further £1.3 billion of PRT that HMRC has repaid during the year relating to other losses relevant to oil and gas fields subject to PRT. These repayments are more than the gross PRT revenue of £0.7 billion recorded for 2015-16. This leads to the negative PRT net revenue figure of £0.6 billion disclosed in Note 2.8 of the Trust Statement.

13 Note 7 to the Trust Statement.

Tax developments during the year

1.16 The following developments are reflected in these financial statements:

- From 2015-16, the remit to levy **Landfill Tax** and **Stamp Duty Land Tax** in Scotland was devolved to the Scottish Parliament. Revenue Scotland now collects these devolved taxes, which are paid to the Scottish government. Some £416 million was collected in 2015-16 for Land and Buildings Transaction Tax and £143 million for Scottish Landfill Tax.[14]

- The Scotland Act 2012 introduced powers for the Scottish Parliament to apply a **Scottish Rate of Income Tax** (SRIT) to the non-savings, non-dividend income of Scottish taxpayers from 6 April 2016. HMRC will continue to collect income tax and will pay over to the Scottish government the amount of revenue it collects relating to the SRIT. HMRC will report the income tax collected relating to SRIT in the Trust Statement from 2016-17.[15]

- In implementing devolution, HMRC recovers any additional costs it incurs from the Scottish government. During 2015-16, it recovered some £8.7 million.[16]

- The Autumn Statement 2014 announced the introduction of the **Diverted Profits Tax** (DPT), effective from 1 April 2015. The aim of the tax is to deter multinational groups from diverting profits out of the UK. DPT is set at a higher rate (25%) than Corporation Tax to encourage businesses to change their arrangements and pay Corporation Tax in line with their economic activities. HMRC is beginning to see evidence of this behavioural change. The decision to issue a charging notice, the point at which the tax becomes collectable, must be approved by a DPT governance board. No DPT revenue was collected in 2015-16.

  The introduction of DPT may lead companies to restructure their tax affairs to pay additional Corporation Tax, rather than pay a higher rate under DPT. HMRC review of a small number of cases indicates an additional £10 million of Corporation Tax has already been received as a result of such restructuring. HMRC continues to review tax returns for the year to establish the full impact of DPT and has not yet included any inital estimate in its compliance yield figure for 2015-16.[17]

- From 1 January 2016, a new **banking surcharge** of 8% has been levied on the taxable profits of banking companies and building societies resident within the UK. HMRC expects a larger number of institutions will pay this banking surcharge than institutions that currently pay the bank levy. The surcharge raised £0.3 billion in 2015-16.

14 Revenue Scotland, *Land and Buildings Transaction Tax Monthly Statistics*, March 2016 and *Scottish Landfill Tax Statistics*, January to March 2016. Available at: www.revenue.scot/sites/default/files/LBTT%20Statistics%20010316%20%20310316.xlsx, www.revenue.scot/sites/default/files/SLfT%20Statistics%20-%20January%20to%20March%202016.xlsx

15 The Comptroller and Auditor General is required under statute to report to the Scottish Parliament on HM Revenue & Custom's administration of the SRIT. He published his first report to the Scottish Parliament on 26 November 2015 (HC 627). His next report is due in autumn 2016.

16 HM Revenue & Customs, *Annual Report and Accounts 2015-16*, p. 152.

17 HM Revenue & Customs, *Annual Report and Accounts 2015-16*, p. 27.

1.17 The Finance Act 2014 allowed HMRC to issue 'accelerated payment notices' requiring payment of tax or National Insurance, or both, that are in dispute as a result of taxpayers' use of a tax avoidance scheme. Several conditions must be satisfied before a notice can be issued. For example, the arrangement used must be notifiable under the 'disclosure of tax avoidance scheme' regime or subject to a 'general anti-abuse rule' counteraction notice.

1.18 These 'accelerated payments' were included in the Trust Statement for the first time in 2014-15. Since then, HMRC has issued more than 46,000 notices. The 2015-16 Trust Statement included £2.1 billion of revenue recognised at the point when the 'notice to pay' was issued, which is before the enquiry or dispute has been resolved. Accelerated payments are not separately disclosed in the Trust Statement but are within the revenue for the related tax. The legal claims provision (paragraph 1.15) includes £240 million for accelerated payments that HMRC has received but which it assesses as likely to have to be repaid.[18]

18 This provision is not netted off the £2.1 billion revenue but is included in the movement in provisions figure and so is included as expenditure in the Trust Statement.

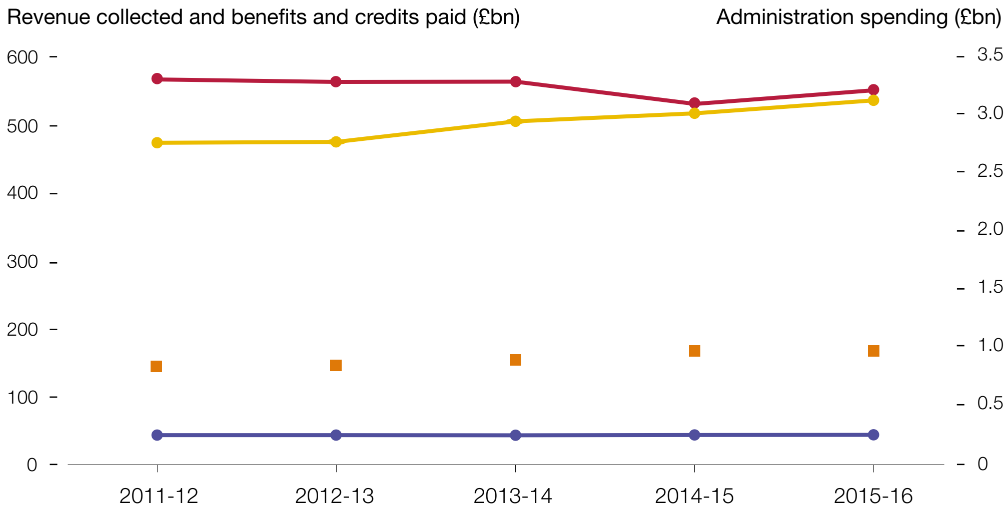
Cost of collecting revenues

1.19 HMRC collected more tax revenue in 2015-16 and continued to pay out similar levels of benefits and credits. As a result, the revenue collected per £1 of spending on administration has increased slightly to £167.06 (2014-15: £166.95) (**Figure 4**). HMRC's biggest cost is staff expenditure of £2.3 billion. The level of staff cost is relatively consistent with 2014-15 as are staff numbers (2015-16: 59,900; 2014-15: 57,100) (**Figure 5**).

Figure 4

Revenue collection, benefits and credits spend and administrative cost

HMRC collected more tax revenue in 2015-16 and continued to pay out similar levels of benefits and credits



	2011-12	2012-13	2013-14	2014-15	2015-16
HMRC administration spending (£bn)	3.3	3.3	3.3	3.1	3.2
Revenue (£bn)	474.2	475.6	505.8	517.7	536.8
Revenue collected per £1 administration spending (£)	143.20	144.58	153.64	166.95	166.75
Benefits and credits spending (£bn)	42.8	42.7	42.5	42.8	43.1

Notes

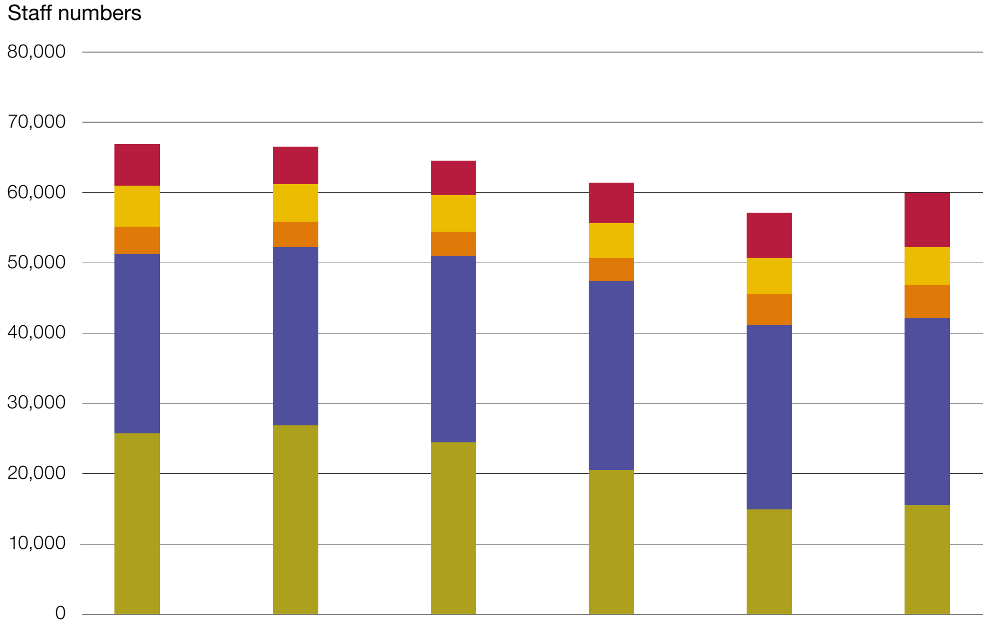
1 Benefits and credits spending includes Resource Accounts subheads: E Social benefits and grants, F Providing payments in lieu of tax relief to certain bodies, K Personal tax credits and L Other reliefs and allowances.

2 Administration spending is Resource Accounts subhead A HMRC administration.

Source: Analysis of HM Revenue & Customs' Resource Accounts and Trust Statement

Figure 5
Staff numbers (full-time equivalent)

Staff numbers (full-time equivalent) have increased slightly in 2015-16 having declined over the previous four years



	March 2011	March 2012	March 2013	March 2014	March 2015	March 2016
Other	5,901	5,279	4,865	5,747	6,358	7,356
Benefits and credits	5,834	5,301	5,157	4,983	5,193	5,459
Business Tax	3,877	3,695	3,410	3,160	4,415	4,583
Enforcement and compliance	25,475	25,334	26,601	26,923	26,222	26,798
Personal Tax	25,796	26,858	24,444	20,558	14,949	15,661
Total staff	**66,883**	**66,467**	**64,477**	**61,371**	**57,137**	**59,857**

Source: HM Revenue & Customs Resource Accounts 2010-11 to 2015-16

Other developments during 2015-16

1.20 In November 2015, HMRC announced that it would reduce its estate from 170 locations to 13 regional sites and four specialist sites by 2027. By 2021, 137 sites will be closed. We would expect to see the impact of this decision in future years' financial statements, for example the reduction in the number of buildings and associated changes to accommodation costs, and the recognition of the costs of staff leaving HMRC.

1.21 In July 2015, HMRC set up a new company, Revenue & Customs Digital Technology Service (RCDTS), a limited company set up, and wholly owned, by HMRC to support and deliver HMRC's digital and technology services. The services transferred to RCDTS in 2015-16 were previously supplied under the Aspire contract, the largest technology contract in government due to expire in 2017. On 1 December 2015, HMRC transferred 138 staff from Capgemini, who work under the Aspire contract, to RCDTS. These staff provide the same service to HMRC but through an HMRC-owned company rather than through external suppliers.

1.22 RCDTS's costs are consolidated into HMRC's Resource Accounts. Its main costs are permanent staff (£2.2 million) and spend on contractors (£3.9 million). Expenditure will increase in future years as more staff are transferred to RCDTS and it provides more services to HMRC. RCDTS's own detailed audited financial statements will be available in the autumn.

Compliance yield

1.23 Compliance yield is an estimate of the additional revenues that HMRC considers it has generated, and the revenue losses it has prevented, from its compliance and enforcement activities. It is one of HMRC's main performance measures and is used to agree targets with HM Treasury for spending on compliance work. Compliance yield is a more direct and timely measure of the impact of HMRC's compliance and enforcement work than the tax gap, which is subject to long reporting delays and other factors outside HMRC's control.[19]

1.24 Compliance activities can take many different forms, such as disrupting organised criminal gangs or tackling the use of tax avoidance schemes. They fall within three groups:

- **Promote:** where HMRC makes complying with tax law easier for the majority of its customers who are willing and able to comply with their tax obligations, for example by designing compliance into its systems and processes.
- **Prevent:** where HMRC stops non-compliance from entering the system.
- **Respond:** where there is non-compliance, HMRC detects it and corrects it.

19 The tax gap is HM Revenue & Customs' estimate of the difference between the amount it should theoretically be able to collect and what it actually collects. Estimating the tax gap is not an exact science but it broadly indicates the trend in tax compliance and HM Revenue & Customs' long-term performance in tackling non-compliance. Comptroller and Auditor General, *HM Revenue & Customs 2014-15 Accounts*, Session 2014-15, HC 18, National Audit Office, July 2015, Part Two.

1.25 Building on our work in 2013-14 and 2014-15, we consider HMRC's progress in taking forward our recommendations and those of the Committee of Public Accounts.[20] We have not verified the accuracy of HMRC's figures.

HMRC's performance in 2015-16

1.26 In 2015-16, HMRC achieved £26.6 billion of compliance yield against a target of £26.3 billion. HMRC had achieved the same amount of yield in 2014-15 against a target of £26.0 billion.

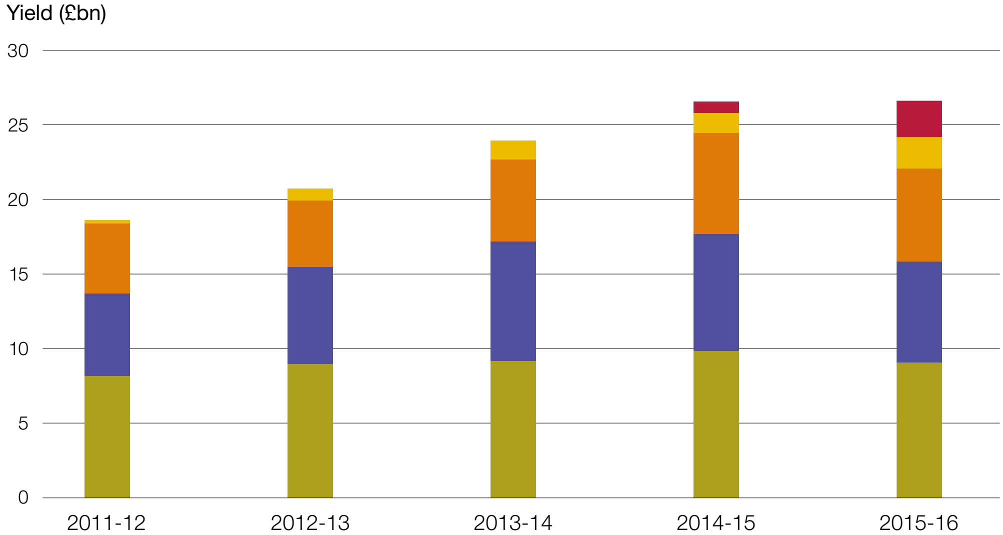
1.27 HMRC split the total compliance yield reported in 2015-16 (£26.6 billion) into five categories (**Figure 6** overleaf):

- **Cash collected** of £9.0 billion (34%), which is an estimate of the extra tax HMRC expects to collect by identifying and challenging non-compliance.
- **Revenue losses prevented** of £6.8 billion (26%), which is tax revenue HMRC has protected each year either by refusing or reducing repayment claims because they are in error or fraudulent or by disrupting organised criminal activity.
- **Future revenue benefit** of £6.2 billion (23%), which is HMRC's estimate of the revenue benefits where it considers it has changed the behaviour of the taxpayers and can be claimed for up to five years.
- **Product and process yield** of £2.1 billon (8%), which is the annual impact of legislative changes made since April 2011 to close tax loopholes and changes to HMRC's processes which reduce opportunities to avoid or evade tax.
- **Accelerated payments** of £2.4 billion (9%), which is the net amount of disputed tax (£2.1 billion) that users of avoidance schemes have paid upfront to, and have received back from, HMRC and £340 million of estimated behavioural impact.

20 Comptroller and Auditor General, *HM Revenue & Customs 2013-14 Accounts*, Session 2014-15, HC 19, National Audit Office, July 2014; HC Committee of Public Accounts, *HM Revenue & Customs performance in 2014-15*, Sixth Report of Session 2015-16, HC 393, November 2015; HC Committee of Public Accounts, *HMRC's progress in improving tax compliance and preventing tax avoidance*, Eighteenth Report of Session 2014-15, HC 458, November 2014.

Figure 6
Compliance yield reported by HMRC since 2011-12

HMRC reported £26.6 billion of compliance yield in 2015-16, more than in any previous year of the 2010 Spending Review period



Yield type	2011-12 (£m)	2011-12 (%)	2012-13 (£m)	2012-13 (%)	2013-14 (£m)	2013-14 (%)	2014-15 (£m)	2014-15 (%)	2015-16 (£m)	2015-16 (%)
Accelerated payments	0	0	0	0	0	0	768	3	2,436	9
Product and process yield	240	1	794	4	1,233	5	1,335	5	2,110	8
Future revenue benefit	4,700	25	4,441	21	5,508	23	6,748	25	6,238	23
Revenue losses prevented	5,509	30	6,512	31	8,003	33	7,869	30	6,795	26
Cash collected	8,178	44	8,975	43	9,182	38	9,838	37	9,028	34
Total	**18,627**	**100**	**20,722**	**100**	**23,926**	**100**	**26,558**	**100**	**26,607**	**100**

Note
1 Percentages shown here do not all add to 100% due to rounding.

Source: National Audit Office analysis of HM Revenue & Customs data

1.28 **Figure 7** shows examples of HMRC's compliance activities and how they result in different types of yield.

1.29 We and the Committee of Public Accounts have previously made a number of recommendations for improving the assessment and reporting of compliance yield (**Figure 8** on page R30).

Figure 7

Examples of HMRC's compliance yield activities

HMRC intervention	Reported yield
HMRC opened an enquiry into a trader's accounts having received evidence of under-declaration of imports in previous tax returns. HMRC worked with the trader to quantify the extent of under-reporting and calculated additional customs duties and VAT payable on the previously undeclared imports.	HMRC has reported cash collected yield of £202,000, representing the additional tax payable by the trader.
A taxpayer submitted a self-assessment return which included significant losses from a marketed tax avoidance scheme. The taxpayer claimed that no tax was payable as a result and applied for losses to be carried-back against income in the prior year. HMRC challenged the taxpayer's use of the tax avoidance scheme and the taxpayer ultimately accepted that losses arising from the scheme could not be used to reduce their tax liability.	HMRC's challenge of the tax avoidance scheme resulted in reported yield of: • £104,000 of **cash collected** as the tax and interest payable after removal of the artificial loss; and • £119,000 of **revenue loss prevented** as the amount of tax protected by rejection of the application to carry-back losses.
HMRC opened an investigation into a taxpayer, as information indicated that the taxpayer was failing to declare income and beneficial loans on their self-assessment returns. HMRC contacted the taxpayer to notify them that they were under investigation for tax fraud and offered a contractual disclosure facility. The offer was accepted by the taxpayer, who provided details of previously undeclared income. A contractual disclosure facility allows taxpayers to admit to past tax fraud and pay the tax due, plus interest and penalties, without the threat of a criminal prosecution provided they fully disclose their deliberate fraudulent behaviour.	HMRC's agreement of a contractual disclosure facility with the taxpayer resulted in reported yield of: • £734,000 of **cash collected** as the tax, interest and penalties payable under the facility; and • £484,000 of **future revenue benefit** over three years from the anticipated impact on the taxpayer's future behaviour.

Source: National Audit Office

Figure 8

Committee of Public Accounts' recommendations and the government's responses

HMRC should ensure the governance arrangements around its key performance indicators are sufficiently robust, and subject to adequate internal and external challenge, before they are reported publicly.

The government agreed with this recommendation. It said that HMRC's management checked the results and that there was scrutiny from HMRC's internal audit function and the National Audit Office. HM Treasury would also have greater oversight of HMRC's compliance yield results.[1]

Our comment on progress: HMRC has strengthened its internal review. Business areas review the processes for compiling their yield cases and consider periodic performance information so they can challenge the data and monitor trends. Internal audit includes reviews of how the yield is compiled as part of its annual programme of work (see paragraph 1.37). We review the robustness of the arrangements HMRC has in place (paragraphs 1.34 to 1.41).

HMRC should be more transparent about its compliance yield estimates in its external reporting. HMRC should continue to publish more detail about how it calculates yield, and should be clearer about how much it has actually collected in cash terms and explain how uncertainty affects its estimates.

The government agreed with this recommendation and recognised the need to provide more information to aid understanding of its complex performance. HMRC will continue to provide explanatory information whenever it publishes its compliance revenue outturns.[1, 2]

Our comment on progress: see paragraphs 1.30 and 1.31.

HMRC should maintain a comparable measure of compliance yield over time and report clearly the impact of any changes it makes to its methodology in its main accountability statements to Parliament.

The government disagreed with this recommendation, as it was not always considered to be practical to make comparisons over time. HMRC considers that assessing the effects of its compliance activities may change so significantly that it would be unable to maintain a comparable time series.[1, 2]

Our comment on progress: while HMRC disagreed with the recommendation, its 2014-15 Annual Report explained how its compliance yield target reflected its 2010 Spending Review settlement and subsequent fiscal events. The compliance yield target for 2015-16 was announced in the 2013 Spending Review with further increments added by subsequent fiscal events. HMRC's 2015-16 Annual Report explains the composition of its compliance yield targets since 2011-12 (page 15), its reporting of different yield types (page 13) and the impact of the proposed changes to the measurement of future revenue benefit from 2016-17 (page 12). Taken together, these disclosures show how the compliance yield measure compares over time.

HMRC should report its compliance yield in much clearer and simpler terms. It should state how much cash its compliance activity has recovered each year, alongside its estimates of future revenue and losses prevented. It should also report the range of uncertainty around its estimates.

The government did not accept the recommendation. HMRC's Annual Report sets out the different elements of compliance yield and acknowledges that calculating them requires a degree of estimation. HMRC is considering ways to report compliance yield more clearly and transparently, including developing the evidence base around the discount applied to the cash collected figure and allocating future revenue benefit estimates to the year of impact. HMRC considers that a range of uncertainty around estimates would add ambiguity and complexity, thus reducing transparency.[3,4]

Our comment on progress: see paragraphs 1.30 to 1.32

Notes

1 HM Treasury, *Treasury Minutes, Government responses on the Eighteenth, the Twenty-first to the Twenty-fourth, and the Thirty-third Reports from the Committee of Public Accounts: Session 2014-15*, Cm 9013, February 2015, pp. 3-4.

2 We made a similar recommendation in our 2014-15 report. Comptroller and Auditor General, *HM Revenue & Customs 2014-15 Accounts*, Session 2014-15, HC 18, National Audit Office, July 2015, R9, paragraph 21.

3 HM Treasury, *Treasury Minutes, Government responses on the Fourth to the Eighth Reports from the Committee of Public Accounts: Session 2015-16*, Cm 9190, January 2016, p. 16.

4 In our 2014-15 report, we also recommended that HMRC should: strengthen its evidence base to support the discount factor it applies to its compliance yield cash collected figure; consider whether its assumptions supporting the scoring of accelerated payments remain relevant; and develop a way to score the tax collected in future years that is consistent between its future revenue benefit and product and process yield categories. Comptroller and Auditor General, *HM Revenue & Customs 2014-15 Accounts*, Session 2014-15, HC 18, National Audit Office, July 2015, R9, paragraph 21.

Source: National Audit Office

1.30 In terms of reporting externally on compliance yield, for example in its Annual Report, HMRC continues to improve its disclosures to make clearer how its yield is calculated. In the '*cash collected*' category, HMRC refers to this as its estimate of additional money due to the Exchequer as a result of its compliance activities during the year. It also recognises that estimates are used as it cannot track the actual payments made by taxpayers as a result of each compliance intervention due to the multiple IT systems HMRC currently uses. HMRC is certain how much additional revenue is due as a result of its compliance activities. However, until it can bring together its records for all taxes, duties and payments into one customer-based record, HMRC cannot state with certainty the precise amount of cash it has collected due to its compliance activities. HMRC expects, within the Spending Review period ending in 2020, to be able to report on the precise amount of cash it has collected.

1.31 HMRC did not accept the Committee of Public Accounts' recommendation that it should provide more quantitative and narrative detail on the impact of its assumptions on the reported compliance yield. We acknowledge HMRC's concerns about the reporting of a range of uncertainties around the estimates it makes: however, we continue to believe that improving transparency and accountability outweighs the risk of added complexity. Such disclosures are important because of the amount of variation in the levels of estimation and uncertainty across the different yield types (**Figure 9** overleaf).

1.32 From 2016-17, following our recommendation, HMRC will report future revenue benefit in the year of impact rather than the year in which it is assessed. The new method is more consistent with the way the rest of compliance yield is reported, although there will still be a degree of uncertainty around the estimation. HMRC has published a technical paper to explain how its change to the scoring of future revenue benefit will affect its compliance yield results. The new approach will help to improve the transparency and internal consistency of HMRC's performance measurement framework.

1.33 In its April 2016 report on tackling tax fraud, the Committee of Public Accounts concluded the way HMRC reported its performance was too confusing and that the impact HMRC claimed for its work far exceeded any reduction in the tax gap. The Committee of Public Accounts recommended that "HMRC should clearly set out in its annual reports the relationship between its compliance yields and changes in the tax gap. It should also publish this information in a way that is accessible for everyone to understand".[21] HMRC has not yet formally responded to this recommendation. However, its Annual Report includes a section covering both compliance yield and the tax gap, and explains how they interact.[22] It is not straightforward to link compliance yield to the tax gap and HMRC describes some of the reasons for this. HMRC also provides an example that describes the relationship between the tax gap and compliance yield for a specific case. This is a useful step in explaining the relationship, but it will take longer-term work to address the issues raised by the Committee of Public Accounts about how HMRC's reported headline performance measures relate to each other.

21 HC Committee of Public Accounts, *Tackling tax fraud*, Thirty-fourth Report of Session 2015-16, HC 674, April 2016.
22 HM Revenue & Customs, *Annual Report and Accounts 2015-16*, pp. 17–19.

Our assessment of the 2015-16 measure

1.34 Our 2014-15 report assessed the robustness of HMRC's methodology for the different types of yield.[23] We have summarised HMRC's progress this year against our previous assessment (Figure 9).

Figure 9

Our assessment of HMRC's scoring methodology

Yield type	Our assessment of HMRC's methodology in 2014-15	Developments in 2015-16
Cash collected £9.0 billion	Assessment of methodology: **Reasonable, but some weaknesses.** Recording cash collected is straightforward. The area for improvement is developing the evidence base for the 10% discount rate, which recognises that some tax liabilities will not be collected.	In 2015-16, HMRC continued to use the discount rate of 10% to recognise that some tax liabilities are not collected. HMRC is undertaking an exercise to strengthen the evidence to support this discount rate. A discount rate will become redundant once HMRC is able to track payments due from taxpayers to cash actually received (paragraph 1.30).
Revenue losses prevented £6.8 billion	Assessment of methodology: **Reasonable.** HMRC records losses prevented when it refuses or reduces repayment claims because they are incorrect or fraudulent. Such losses prevented make up around two-thirds of the total revenue losses prevented. The methodology for calculating such losses prevented is straightforward and well understood. The benefit to the Exchequer is clear and specific. The methodology for revenue losses prevented from the disruption of criminal activity contains some weaknesses. Amounts scored are based on cases where revenue would have been lost if the criminal activity had not been successfully disrupted. The scoring assumes that none of the revenue loss disrupted has been displaced to rival gangs or different criminal activities. HMRC could do more to validate this assumption.	There has been no change to the methodology since 2014-15.
Future revenue benefit £6.2 billion	Assessment of methodology: **Not straightforward and at risk of being subjective.** Whenever it concludes a compliance investigation, HMRC assesses whether, and for what period, it should record the future revenue benefits. HMRC recognises that the estimates of future revenue benefit entail a degree of uncertainty. It has established guidance that explains how its staff should estimate the yield. This guidance limits the number of years HMRC can score an impact, and requires evidence of the taxpayer's commitment to change and information to support amounts scored.	There has been no change to the methodology in 2015-16. In 2014-15, we recommended that HMRC develop a way to score the tax collected in future years that was consistent between its future revenue benefit and product and process yield categories.[1] In response, HMRC intends, from 2016-17, to report its future revenue benefit yield in the year of impact (paragraph 1.32). HMRC's preliminary analysis, available in its Annual Report, indicates that the impact of this new approach on the total reported compliance yield will not be significant. The new approach will ensure HMRC's performance measurement framework is consistent and more transparent.

23 Comptroller and Auditor General, *HM Revenue & Customs 2014-15 Accounts*, Session 2014-15, HC 18, National Audit Office, July 2015, R43, Figure 16.

Figure 9 *continued*

Our assessment of HMRC's scoring methodology

Yield type	Our assessment of HMRC's methodology in 2014-15	Developments in 2015-16
Product and process £2.1 billion	Assessment of methodology: **Reasonable.** The calculation of amounts is subject to external review by the Office of Budget Responsibility and supported by appropriate documentation.	There has been no change to the methodology.
Accelerated payments £2.4 billion (including £340 million of behavioural impacts)	Assessment of methodology: HMRC reports the cash amounts it has received under this scheme during the year and the cash amounts it has repaid. **This is a simple approach which does not involve any estimation.** There is no adjustment for the possibility that cash received in individual cases may have to be repaid in future years, or for the possibility that the final award to HMRC may be higher than the cash already received. HMRC will keep the way this scheme is scored under review. The calculation of the behavioural impact of the accelerated payments legislation is subject to review by the Office for Budget Responsibility.	There has been no change to the methodology. HMRC believes that reporting the yield based on the actual amount of cash collected, net of repayments, is reasonable as this is the actual impact on the Exchequer and is when the impact of the accelerated payment notices as a deterrent is realised. The application of estimates for amounts that may need to be repaid would detract from the impact achieved.

Note

1 Comptroller and Auditor General, *HM Revenue & Customs 2014-15 Accounts*, Session 2014-15, HC 18, National Audit Office, July 2015, R9.

Source: National Audit Office

1.35 We assessed HMRC's methodology for estimating compliance yield, including a sample of case files across its various lines of business. Our findings fell into four areas:[24]

- data quality;
- estimation and uncertainty;
- transparency in reporting; and
- internal consistency.

Data quality

1.36 HMRC's processes for assuring the robustness of the compliance yield measure are well developed and effective. HMRC guidance explains how its staff should measure different types of yield. HMRC has processes to check compliance with the guidance and to challenge the reasonableness of assumptions. However, HMRC's quality assurance processes are not equally well developed across its different compliance activities. The quality of data underpinning the reported yield varies considerably between different compliance teams within HMRC. This can introduce inconsistencies in the reporting of performance data and increase the risk of inaccurate results.

1.37 Internal audit carried out three compliance yield reviews in 2015-16. Their findings were consistent with our results.

24 We reviewed 74 cases across different teams (specialist and criminal investigations, counter avoidance, business tax and personal tax). This was not a statistically representative sample of the total population of compliance yield cases to enable us to conclude on the accuracy of the reported compliance yield.

Estimation and uncertainty

1.38 HMRC's reported compliance yield is an attempt to reflect the impact of all of its tax compliance activities. Compliance yield is important as an internal performance measure for HMRC so that the department can understand the impact of the resources deployed in different enforcement and compliance areas.

1.39 HMRC did not design compliance yield to be a cash-based measure and it necessarily includes a degree of estimation. HMRC measures the majority of its compliance yield based on individual compliance interventions, covering current and past non-compliance. HMRC's methodology and processes for estimating compliance yield are sound. However, the levels of estimation and uncertainty vary considerably across the different yield types. For example, while most revenue losses prevented are known amounts from refused repayment claims, some are related to the disruption of criminal activities, which are more uncertain. Future revenue benefit is an estimate and is scored where sufficient evidence exists that a compliance intervention will affect future tax returns. There is a level of uncertainty in these cases because HMRC cannot be sure how taxpayers will behave in future. HMRC does not routinely carry out retrospective checks on its compliance cases to confirm its activities have resulted in the expected cash collection, loss prevention or behavioural change.

Transparency in reporting

1.40 HMRC continues to improve the clarity and transparency of the way it reports compliance yield in its Annual Report, which includes:

- further details on HMRC's challenges in tracking payments made against its compliance interventions;
- a link to a technical paper that sets out changes to HMRC's methodology for reporting future revenue benefit and the likely impact of its new approach on the total reported compliance yield; and
- a section on the new Diverted Profits Tax – this tax is intended to combat artificial business structures created solely to minimise tax liabilities.

Internal consistency

1.41 HMRC's compliance work covers a wide range of activities, which are reflected in the different yield types. HMRC has improved the methodology for its performance reporting framework to allow the various types of yield to be scored consistently. From 2016-17, future revenue benefit will be scored in the year it relates to rather than the year in which the intervention took place. This is similar to the approach used in reporting product and process yield.

HMRC's objectives from 2016-17

1.42 HMRC has revised its framework of external and internal performance measures for 2016-17 and beyond so it aligns with its approach and structure arising from its transformation programme (see Part Two).[25] HMRC's three strategic objectives, and its broad approach to tracking performance against these, are summarised in **Figure 10**.

Figure 10
HMRC's objectives from 2016-17

Objective	Summary of HMRC's intended approach to tracking performance
Maximise revenues due and bear down on avoidance and evasion	Raising compliance revenue – a compliance yield target will be set each year as part of the Budget.
	Increasing the number of criminal investigations that HMRC can undertake into serious and complex tax crime, focusing particularly on wealthy individuals and corporates, with the aim of increasing prosecutions in this area to 100 a year by the end of the Parliament.
	Tackling tax credits error and fraud – each year HMRC will set targets for the year ahead.
Transform tax and payments for customers	Delivery of multi-channel digital services. For example, HMRC intends that, by 2019-2020, most small businesses will interact with its systems directly via accounting software. Roll-out will be completed by 2020-21.
	Improving customer services – HMRC aims to track this across a range of customer-focused measures. These will include number of call attempts handled, call wait times and response times for handling post; service standards on accessibility, timeliness, quality and resolving issues on first contact for all contact channels and customer satisfaction for the digital experience.
	Reducing business costs. HMRC aims to reduce the annual cost of tax administration to businesses by £400 million by 2019-20.
Design and deliver a professional, efficient and engaged organisation	Making sustainable savings. HMRC aims to deliver sustainable cost savings of £717 million a year by the end of 2019-20 and a total of £1.9 billion in efficiency savings over the Parliament. This will come from digitising tax collection and employing a smaller but more highly skilled workforce.
	Engaging and developing HMRC's staff – HMRC aims to improve employee engagement and achieve the civil service employee engagement index benchmark, which in 2015 was 58%.

Source: HM Revenue & Customs, *Single Departmental Plan 2015 to 2020*, updated May 2016

25 HM Revenue & Customs, *Single Departmental Plan 2015 to 2020*, updated May 2016. Available at: www.gov.uk/government/publications/hmrc-single-departmental-plan-2015-to-2020

Part Two

HMRC's transformation plans

2.1 Last year we reported on HM Revenue & Customs' (HMRC's) plans to transform how it administers tax. We said that although plans were at an early stage it was clear that the scale of the transformation was significant and more complex and far-reaching than previous change programmes. We said we would report on progress as the programme developed.

2.2 In the past year, HMRC completed its preparations for transformation and is now implementing the changes. This part of the report covers:

- how HMRC's plans have developed since last year;
- how HMRC plans to manage its transformation;
- ongoing risks and challenges; and,
- arrangements for accountability and external scrutiny.

We will return to evaluate the effectiveness of HMRC's management of its change programme in future years, when the new processes are more established.

How HMRC's plans have developed since last year

2.3 HMRC's stated vision is to have "one of the most digitally advanced tax administrations in the world".[26] The vision is not just about more online services. HMRC will need to transform its whole organisation to achieve its aim, making significant changes in parallel. By 2021, it expects to employ 16% less staff who will mostly be working in 13 regional centres, a substantial rationalisation of its estate resulting in the closure of 137 of its locations (90%). More of its processes will be automated, and a higher proportion of its staff will undertake specialist work to challenge those taxpayers who seek to avoid or evade their tax liabilities. HMRC will fundamentally change how it buys its IT services as it replaces its Aspire contract. HMRC expects most taxpayers will be using new online systems to manage their tax affairs by 2020 (**Figure 11**).

26 HM Revenue & Customs, *Single Departmental Plan 2015–2020.* Available at: www.gov.uk/government/publications/hmrc-single-departmental-plan-2015-to-2020

Figure 11

What making tax digital means for HMRC's customers

Examples of the ways that HMRC's plans will affect taxpayers

Now	By 2020, HMRC expects
Most interactions between customers and HMRC are on the phone or by post.	Nearly all customers will be maintaining their tax records and paying tax online, supported by webchat or secure email. Face to face and telephone support will still be available for those who need it.
Businesses tell HMRC about their tax position annually for most taxes, quarterly for VAT.	Most businesses will provide HMRC with quarterly updates about their financial position. Businesses will have a clearer picture of their tax liability during the year. Businesses will use digital tools to track income and expenditure throughout the year.
Employers provide HMRC with real-time information about employees' income. Individuals tell HMRC about their tax position annually, or when a taxable event occurs (such as inheritance or a capital gain). For some customers, it is time-consuming to correct overpayments and underpayments of tax.	Individuals will see information about all their taxes in one place, with real-time information for employees about income, benefits in kind and personal allowances. Fewer errors as more information is pre-populated by HMRC, and more accurate calculation of taxes each month for those with complex tax affairs.

Source: National Audit Office analysis of HM Revenue & Customs publications

2.4 HMRC's vision builds on earlier investments to join up services, simplify processes, make better use of data and use modern technology. In particular, its plans build on work undertaken over the last ten years to modernise the pay-as-you-earn (PAYE) system through which most of HMRC's customers pay their tax. In 2009-10, HMRC created a national PAYE system, which provided a single national dataset for employees' income tax and national insurance payments. In 2013-14 it launched Real Time Information to improve the timeliness and accuracy of its data on employees' income.

2.5 HMRC has strong reasons for wanting to develop and expand the use of digital tax accounts over the next few years. These plans are aligned with HMRC's strategic objectives to maximise compliance, increase efficiency and improve the experience of taxpayers and its earlier investments to automate and modernise the tax system.

2.6 Critical to implementing these plans successfully will be HMRC's ability to build public trust in its new digital services. This requires these services to be both easy to use and secure. As HMRC's data becomes increasingly digitised and integrated, the importance of protecting its systems against data loss and cyber attack also rises. HMRC is therefore investing resources and expertise in making its data more secure and ensuring access to sensitive tax data in particular is safeguarded. It must also demonstrate to taxpayers that its controls to verify each taxpayer's identity and protect the confidentiality of data are working effectively.

2.7 HMRC has been planning the next stage of its transformation for the past two years. Since our review last year it has:

- made plans to spend more than £2 billion to achieve its vision over the next five years;
- agreed with HM Treasury the high-level outcomes it will achieve over the next four years and secured £1.3 billion of new investment funding. HMRC expects to spend £1.8 billion on transformation in total over that period, with the balance of funding coming from existing budgets;
- launched digital tax accounts for individuals, giving customers access to the first phase of its online services. HMRC reported that over one million customers had used the new accounts by April 2016;
- announced its plans to close 137 offices (90% of its locations) and the location of its 13 new regional hubs and four specialist sites where almost all its staff will be based within the next ten years; and
- secured ministerial and supplier agreement for its plans to replace its IT services contract, Aspire, which it has revised to reduce the risk of carrying out too much change too quickly.[27]

2.8 To agree funding from HM Treasury for its plans, HMRC estimated the costs and benefits of transformation over the next five years. Its plans are based on investing at least £2 billion on its transformation over the next five years (**Figure 12**). Almost 90% of its investment is in three areas: making tax digital, improving compliance and its estates rationalisation. It expects this investment to reduce running costs by more than £700 million and increase tax revenues by £1 billion over the next five years.[28] HMRC expects three of its seven directorates to provide three-quarters of the planned efficiencies – enforcement and compliance, personal tax and information technology (**Figure 13** on page R40). HMRC expects almost half the savings in 2016-17 to come from the information technology (Chief Digital and Information Officer's directorate), primarily from replacing the Aspire contract.

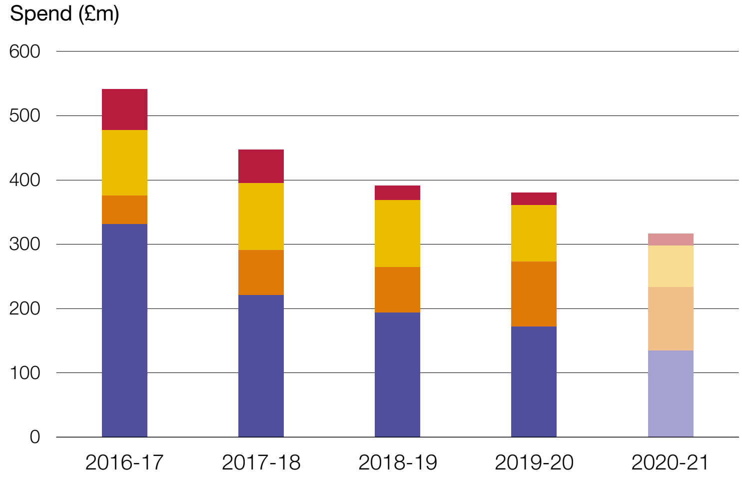
27 Comptroller and Auditor General, *Memorandum: Replacing the Aspire contract*, Session 2016-17, National Audit Office, June 2016.

28 These figures differ from HMRC's public statements about its settlement at the Autumn Statement, which covers a different time period (four years rather than five) and includes savings from a wider range of initiatives such as pay restraint and continuous improvement. Figures referred to here are based on HMRC's estimates of the costs and benefits of its transformation only.

Figure 12

HMRC's estimate of total spend on transformation to 2020-21

Most of HMRC's spend will be on digital transformation



	2016-17	2017-18	2018-19	2019-20	2020-21
Digital transformation	332	221	194	172	134
Estates	45	70	71	102	99
Supporting compliance	102	104	104	87	64
Other Programmes	63	52	22	20	19
Total	**542**	**447**	**391**	**381**	**316**

Notes

1 Spending plans for 2016-17 to 2019-20 have been agreed with HM Treasury. HMRC's estimates of spend in 2020-21 have yet to be agreed.

2 Supporting compliance involves changes to enable a more intelligence-led approach to compliance and enforcement.

3 Estates includes establishing 13 regional hubs and 4 specialist sites and transition support.

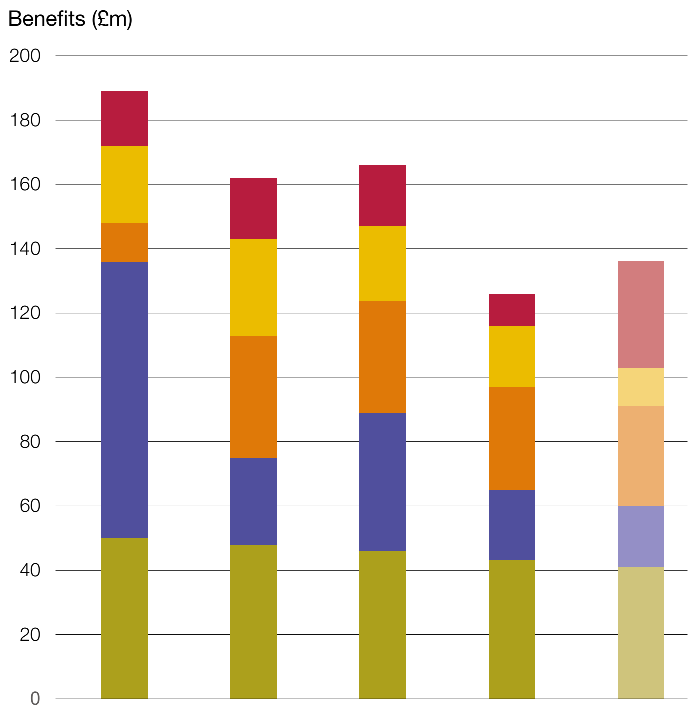
4 Digital transformation includes the modernisation of tax administration for individuals and businesses.

5 Other programmes include leadership development and support for the wider government agenda.

Source: National Audit Office analysis of HM Revenue & Customs data

Figure 13
Where HMRC expects savings from transformation to come from

Most of the expected savings will come from the Chief Digital and Information Officer's and the Enforcement and Compliance directorates



	2016-17	2017-18	2018-19	2019-20	2020-21
Chief Finance Officer	17	19	19	10	33
Personal Tax	12	38	35	32	31
Chief Digital and Information Officer	86	27	43	22	19
Enforcement and compliance	50	48	46	43	41
All other areas	24	30	23	19	12
Total	**189**	**162**	**166**	**126**	**136**

Notes

1 Efficiency savings for 2016-17 to 2019-20 have been agreed with HM Treasury. HMRC's estimates of efficiencies from transformation in 2020-21 have yet to be agreed.

2 All other areas includes the following directorates: Chief People Officer, Benefits and Credits, Legal, Business Tax, Central Tax and Strategy.

3 These figures are HMRC's estimates of the benefits of its £2 billion investment in its transformation over the next five years. They do not reconcile to HMRC's public statements about benefits in its settlement with HM Treasury which only covered four years and included savings from across HMRC's business, not just transformation.

Source: National Audit Office analysis of HM Revenue & Customs data

2.9 Predicting the costs, benefits and key milestones of a transformation like this over the longer term is inherently difficult because:

- significant changes will be made in parallel across the organisation and many are interdependent;
- the success of the plans depends on how taxpayers' behaviour changes in response to new services, which is difficult to predict;
- some factors affecting the speed of change are outside HMRC's control; and
- funding for future years depends on HMRC successfully generating savings in the earlier years.

2.10 HMRC's projections of spending on and savings from transformation are set out in Figures 12 and 13. We would expect these plans to change over time as HMRC takes account of progress against key milestones and learns from experience.

How HMRC plans to manage its transformation

2.11 When we reported on HMRC's management of its Aspire contract for IT services in 2014, we concluded that HMRC has a strong track record in delivering IT projects.[29] But this transformation will be more complex and challenging than any change HMRC has implemented before, and will require a different management approach. When we reported last year we identified managing the high levels of complexity and ambition in HMRC's plans as a major challenge. HMRC and HM Treasury have recognised and accept that the high level of complexity in an integrated organisation-wide change programme means HMRC's plans over the longer term are more uncertain than a more conventional and self-contained change programme would be.

2.12 HMRC has adapted its approach to leading and managing change to handle these higher levels of risk and uncertainty. Its leadership team has worked together to plan the transformation. There is strong engagement at a senior level. All members of the senior team are responsible for delivering and supporting transformation. It has also created a new role at board level, the Director General for Transformation, to be a focal point in its senior team for transformation. HMRC formed eight major programmes to deliver the changes, although it recognises that the programmes are heavily interdependent. HMRC is managing its investment in these programmes as a portfolio to help it prioritise its resources and manage risk. It has put in place a rolling programme of business planning and governance, seeking to learn and apply the lessons from its experience as projects mature.

2.13 There is no single right answer about how to manage a change programme of this magnitude. We consider that the responsibilities and governance arrangements put in place by HMRC, with the support of HM Treasury and Cabinet Office, look credible and proportionate to the risks involved. But it is too early to evaluate how HMRC's approach is working, as the new arrangements have only been operating for a few months.

29 Comptroller and Auditor General, *Managing and replacing the Aspire contract*, Session 2014-15, HC 444, National Audit Office, July 2014

2.14 HMRC needs to maintain a clear view of whether it is on track to achieve its strategic goals. It must monitor its progress against a robust set of interim milestones. 2016-17 is the year of greatest activity in terms of both spending and the benefits HMRC expects to achieve. It will therefore be particularly important for HMRC to take stock of its progress early in 2017-18, and learn lessons and refresh its plans as necessary.

2.15 At this stage, HMRC has a relatively high-level view of how the progress of each individual change programme depends on other programmes. This increases the uncertainty about what might happen if a project with multiple dependencies is delayed. It may create additional and unpredictable costs and consequences as timetables for introducing new services and infrastructure change, as they inevitably will. In such an extensive change programme, it would be easy for HMRC to lose sight of progress towards its vision through small changes to the timing or scope of projects which are mutually dependent. HMRC is developing a more detailed view of these dependencies.

2.16 With such high levels of change we would expect any organisation to experience setbacks and difficulties with implementation as it designs and launches new services. When this has happened in the past, such as when HMRC created a national PAYE system, HMRC did not lose sight of its long-term objective. It committed serious effort to stabilising the system and tackling a significant backlog of unresolved cases. As we said a year ago, HMRC will need such commitment and resilience if it is not to be deflected from achieving its strategic vision. One of the most critical tests of HMRC's approach will be how management responds when things do not go as expected.

Ongoing risks and challenges

2.17 Our review last year identified three challenges HMRC would face delivering its transformation plans:

- transforming its business while changing how it buys its IT services under the programme to replace its existing contract for IT services, Aspire (see paragraph 2.18 below);
- the need to balance its ambitions with realism about its critical assumptions and make contingency plans (see paragraph 2.19); and
- developing the right management information to measure the costs and benefits of its investment (see paragraph 2.20).

2.18 HMRC has revised its approach to replacing its Aspire contract since we reported last year. It has agreed with ministers and Aspire suppliers to execute a phased approach to replacing Aspire that it judges will reduce the technical and operational risk and give it the continuity it needs to carry out its transformation plans, protect tax revenue and maintain customer service standards. The first phase commenced in 2015 and the last phase of the replacement is now due to be completed in 2020.[30]

30 See footnote 27.

2.19 HMRC's past experience demonstrates that there are serious risks if major assumptions underpinning its strategy do not prove realistic. For example, achieving HMRC's vision relies on the critical assumption that taxpayers will move over to online services and reduce the demand for telephone and postal services. In the last Parliament, HMRC made over-optimistic assumptions about how much change it could make all at once. To live within its spending plans, it released customer service staff before it had reduced the demand from personal taxpayers for contact by phone. This significantly impaired the quality of its service for some 18 months. HMRC has since recovered its overall service levels. It ended the year with calls answered at 72% of the total calls received over the year; and in the last quarter, it answered 87% of calls with an average speed of answer of less than six minutes. HMRC has adjusted its future resource plans in light of this experience. It is now monitoring closely the way taxpayers respond to changes in the way services are provided, including how demand for online and telephone services is changing. HMRC also needs to model the impact of different scenarios and monitor leading indicators of the success of its strategy. This is so that it can intervene early to ensure that any setbacks in implementing new services do not damage its service to customers or its ability to collect tax.

2.20 HMRC plans to develop a full picture of what it will cost taxpayers to use the new systems over the next year and its initial assessment will be published alongside the consultation documents this summer. HMRC has not yet estimated the costs for individual taxpayers or businesses of making the transition to online services or sought to quantify the benefits they can expect. Most business customers will have to update HMRC quarterly rather than annually about their tax affairs. They may need to buy new software that works with the new systems. The business community is sceptical of HMRC's evaluations of the costs and benefits of previous changes to the tax system. The business case for Real Time Information estimated that the new service would save businesses £300 million a year in compliance costs. HMRC established an Administrative Burdens Advisory Board to understand more about the costs and benefits to businesses of using real-time information. Working with this group of stakeholders led HMRC to reduce its estimate of the annual saving to businesses marginally to £292.5 million. Some businesses remain sceptical that access to real-time information has reduced their costs at all.[31]

Arrangements for accountability and external scrutiny

2.21 Few government departments have attempted this level of change across a whole organisation. At this early stage, it is inevitable that HMRC's plans should contain uncertainty about what will be delivered, by when and at what cost (paragraph 2.9). HMRC faces a challenge in being transparent about its plans, and could do more to help the public and Parliament understand what it is doing and where there is uncertainty.

2.22 HMRC is using shorter-term milestones to monitor its progress. It is agreeing spending plans and performance targets with HM Treasury annually so that it can learn

31 Comptroller and Auditor General, *The quality of service for personal taxpayers*, Session 2016-17, HC 17, National Audit Office, May 2016.

from experience and alter its plans as things change. This is a realistic and prudent approach, given the scale of what HMRC is doing and the inevitability that not everything will go according to plan.

2.23 The process of governance and approvals by the centre of government is also designed to challenge and provide assurance about the value for money of HMRC's activities. The Infrastructure and Projects Authority, the part of Cabinet Office with responsibility for assuring government's major projects, will review progress on most, if not all, of HMRC's eight transformation programmes. HM Treasury will track HMRC's progress against its plans and will:

- challenge and approve spending on each programme, when business cases are submitted;
- monitor HMRC's performance compared to plans using a wider range of indicators than those HMRC reports publicly; and
- work with Cabinet Office, to test proposals for compliance with their spending controls (for example, on consultancy spend) and consider the case for exceptions where relevant.

2.24 The nature of public statements in successive Budgets and Autumn Statements about the scale of HMRC's investment and the expected benefits is that they have been incremental and partial, rather than describing the whole of HMRC's transformation plans in a single place. This process has made it difficult for Parliament or the public to understand or reconcile the data released in such statements, which risks creating confusion and obscuring accountability. For example, HMRC's public statements about the cost of transformation had focused on the new investment of £1.3 billion announced by the Chancellor in December 2015, and not the total expected cost of transformation, which is higher at £1.8 billion over the same period (paragraph 2.7). HMRC has clarified this in its Annual Report 2015-16, bringing together the total costs and benefits it expects from its investment in transformation in one place. We would expect HMRC to show in successive annual reports how its plans are evolving and what it has delivered in practice over the next four years.

Part Three

Improving the management of tax reliefs

3.1 Tax reliefs are integral to the tax system and an important tool for public policy, covering most areas of government activity. There are more than 1,100 tax reliefs and several different types.[32] Many have social or economic objectives, while others specify the boundaries and thresholds of tax. Tax reliefs' common characteristic is that they either reduce the tax payable or generate a payment. This can make them the focus of tax avoidance. Of 30 'spotlights on tax avoidance' published on HM Revenue & Custom's (HMRC's) website, 13 refer directly to a tax relief, while others may be linked to one or more reliefs that are not named.[33]

3.2 In 2014, we reported twice on tax reliefs, highlighting the need for greater transparency about the costs and use of reliefs.[34] We identified examples where HMRC proactively monitored and evaluated tax reliefs, but in general found that it did not test whether tax reliefs were achieving their aims. Without regular review of reliefs, significant risks might go undetected.

3.3 In 2015, the Committee of Public Accounts concluded that HMRC needed to improve how it monitors and reports on tax reliefs. It made five recommendations, two of which HMRC accepted. HMRC agreed to:

- draw up a set of principles to guide its management and reporting of tax reliefs that makes clear how it will carry out its responsibility to monitor, evaluate and assess tax reliefs; and
- regularly monitor variances between its forecasts of what tax reliefs will cost and what they actually cost. Where costs significantly exceed forecasts, it agreed to seek positive evidence the relief is working as intended and is not a target for tax avoidance.[35]

32 The Office of Tax Simplification identified 1,156 tax reliefs in a March 2015 publication. These relate to 23 different tax streams. The full list of tax reliefs is available here: https://taxsimplificationblog.files.wordpress.com/2015/03/ots-list-of-tax-reliefs-updated-to-march-2015.xls

33 HMRC publishes a series of 'spotlights', warning taxpayers about certain tax avoidance schemes. The series is available here: www.gov.uk/government/collections/tax-avoidance-schemes-currently-in-the-spotlight

34 Comptroller and Auditor General, *Tax reliefs*, Session 2013-14, HC 1256, National Audit Office, April 2014, and Comptroller and Auditor General, *The effective administration of tax reliefs*, Session 2014-15, HC 785, National Audit Office, November 2014.

35 HM Treasury, *Treasury Minutes: Government responses on the Thirtieth, the Thirty-fifth, the Thirty-seventh, and the Forty-first to the Fifty-third reports from the Committee of Public Accounts: Session 2014-15*, July 2015. See recommendations 1 and 3 of the Forty-ninth report.

3.4 HMRC also outlined plans to improve its reporting of tax reliefs, despite rejecting the Committee's recommendation to publish and maintain an up-to-date list of tax reliefs. HMRC said that it would provide more information on past changes to estimates, comparisons between forecasts and actual costs and commentary on significant variances for around 180 reliefs.[36]

3.5 This Part considers how HMRC is seeking to:

- develop good-practice guidance for managing tax reliefs;
- implement good practice in its administration of reliefs;
- ensure it manages tax reliefs proportionately; and
- improve its reporting on tax reliefs.

3.6 We examine the specific steps taken by HMRC in response to recent reports and we test progress and the adequacy of these responses using six case study reliefs (**Figure 14**).

Developing good-practice guidance for managing tax reliefs

3.7 In general, HMRC designs and delivers tax reliefs and manages the compliance risks associated with them as part of its administration of the whole tax system. For instance, it manages the risk that avoidance schemes target tax reliefs as part of its general counter-avoidance work, which considers all aspects of the tax system. Responsibility for administering tax reliefs lies with the relevant 'product and process owner'. A product and process owner is responsible for a specific area of tax. In some cases, they are responsible for a whole tax stream, such as capital gains tax; in others, for a relief or a group of reliefs within a wider area of tax, such as income or corporation tax. They are accountable for ensuring that the products they manage operate as effectively as possible to deliver HMRC's strategic objectives.

3.8 For each tax relief, the product and process owner is required to

- review the policy design;
- decide which administrative processes are needed to mitigate relevant risks; and
- ensure the reliefs are taken up by the right target population.

3.9 HMRC has said it is committed to adopting best practice in the design, monitoring and evaluation of tax, including tax reliefs. It recognises that good design of tax reliefs is important in ensuring that they work as intended, are protected from misuse and are efficient to manage.

36 HM Treasury, *Treasury Minutes: Government responses on the Fourth to the Eighth reports from the Committee of Public Accounts: Session 2015-16*, January 2016. See recommendations 3 and 4 of the Sixth report.

Figure 14

Six case study reliefs

Description	Objective	Age	Cost (2015-16 forecast)
Principal private residence relief exempts an individual's main home from capital gains tax	Support homeowners	Long-standing (40+ years)	£18 billion
Entrepreneurs' relief reduces capital gains tax to 10% for certain disposals (for instance, all or part of a business)	Encourage enterprise	Recently introduced (3–10 years)	£3 billion
Patent box gives companies a deduction which is equivalent to charging a reduced 10% rate of corporation tax on profits from patented inventions	Stimulate innovation	New relief (0–3 years)	£675 million
High-end TV tax relief allows producers to claim an additional deduction or a payable tax credit when computing taxable profits	Support UK TV industry	New relief (0–3 years)	£120 million
Investing in **Venture Capital Trusts** provides income tax relief on the amount invested, tax-free dividends and exemption of chargeable gains on disposal of shares	Encourage investment in small companies	Established (11–40 years)	£80 million
Interest paid on qualifying loans is eligible for income tax relief. Examples include loans to buy productive assets such as plant or machinery, an interest in a 'close' company, or to pay inheritance tax	Reduce barriers to finance for small business	Long-standing (40+ years)	Not known We estimate it cost £170 million in 2013-14[1]

Note

1 We used HMRC's data on interest deducted on self-assessment returns and the relevant income tax rate for each taxpayer to calculate our estimate for tax relief on qualifying loans interest.

Source: National Audit Office analysis of HM Revenue & Customs published information on tax reliefs and HM Revenue & Customs management information

3.10 HMRC set out good-practice principles for governing and administering tax reliefs in September 2015, within two months of accepting the Committee of Public Accounts' recommendation (**Figure 15**). This guidance adopts many of the features of good practice we would expect including:

- requiring all reliefs to be identified and risk-assessed;
- designing processes to provide useful information without undue cost; and
- reviewing and evaluating reliefs regularly (including how much they cost, take-up rates and whether they fulfil policy objectives).

3.11 Although HMRC's new guidance provides an important first step, we believe it requires further development. The Organisation for Economic Co-operation and Development (OECD) has undertaken work to identify best practice administration of tax reliefs. It concluded that the allocation and administration of tax expenditures should be reviewed in the same way as normal government spending. But there does not appear to be a consensus on the way reliefs should be managed, with countries adopting various different approaches. In past work we identified a number of good examples from administrations abroad.[37]

3.12 HMRC based its new guidance on what it felt was working well within the Department, without seeking to learn from its counterparts overseas. It has also not included in its guidelines some of the good practices that its teams already demonstrate. For example, some teams have established links with other government departments: the team administering high-end TV relief relies on the British Film Institute to determine which productions are eligible for the relief. Drawing on our previous work and its own good practice, we consider that HMRC could improve its guidance in each area (Figure 15).[38]

3.13 The extent to which product and process owners comply with the good-practice principles is likely to vary because:

- reliefs perform different functions and carry different risks;
- no-one has responsibility for monitoring implementation of the new guidance; and
- there was a lack of awareness among those we spoke to that the guidance was intended to be compulsory.

37 Comptroller and Auditor General, *The effective administration of tax reliefs*, Session 2014-15, HC 785, National Audit Office, November 2014, Part Four and Figure 22.
38 Comptroller and Auditor General, *Tax reliefs*, Session 2013-14, HC 1256, National Audit Office, April 2014, Appendix Three.

Figure 15

Evaluation of HMRC's guidance for managing tax reliefs

HMRC guidance sets out many of the characteristics we would expect for the effective administration of tax reliefs

Overall governance

- Maintain a list of tax reliefs contained in each tax product
- Identify key risks to the tax products, including where these relate to tax reliefs
- Articulate a clear policy objective for new tax reliefs and clear evaluation criteria at the outset
- Include tax reliefs within the regular review of the tax

Good practices not included

- Categorise reliefs to inform governance, resources and reporting requirements
- Establish links with related areas of government

Design

- Ask counter-avoidance specialists to check new reliefs for avoidance risk
- Engage with customers and stakeholders to anticipate demand, develop a user-friendly design, and promote take-up to the right target groups
- Reflect compliance risks in the Department's risk registers
- Where possible, design administative processes to provide useful information for future evaluation of the relief. Avoid unnecessary burdens on customers

Good practices not included

- Test a range of options for administration before choosing a tax relief
- Include a timeframe for review of the relief

Administration

- Determine appropriate administration of reliefs, including:
  - whether specialist units or compliance leads are necessary;
  - how to monitor the relief, and
  - the national approach to compliance for the relief.

Good practices not included

- Advise product owners of the factors they should take into account when deciding how to administer their relief
- Risks are regularly re-assessed and mitigated

Monitoring and evaluation

- Monitor impacts in relation to the initial objectives and estimated costs, including any incentive effects
- Identify threats including the abuse or misuse of the reliefs
- Agree with internal stakeholders which statistics and costs to publish
- Conduct ongoing reviews and periodic evaluations of the reliefs to monitor the costs, usage trends and policy objectives

Good practices not included

- Assess the value of tax at risk, quantifying where possible
- Investigate variances in the cost or use of reliefs

Note

1 HMRC notes there are examples of good practices which are already being implemented by some teams, but which are not included in its guidance. These include: links with related areas of government, discussion with product and process owners when analysts find significant differences in the cost of reliefs, risk assessment by policy teams.

Source: National Audit Office analysis of HM Revenue & Customs guidance

Progress implementing good practice

3.14 During our review in spring 2016, HMRC did not expect its formal product plans for each area of tax to reflect changes from the guidance. Product and process owners prepare annual plans each summer. We looked for signs of progress in improving how HMRC manages reliefs by:

- seeking evidence that product and process owners were developing lists of tax reliefs to inform annual planning; and
- examining a sample of six tax reliefs from three tax areas to find out whether changes had been made or were planned.

3.15 Under the new guidance HMRC asks product and process owners to maintain a comprehensive list of reliefs they are responsible for. In March 2016 we asked HMRC to provide the lists of tax reliefs produced by each product and process owner and found that no such lists had yet been developed. Each of our six sample reliefs was listed in existing product plans, but the purpose of these plans, and the extent to which they covered administration of reliefs, varied significantly:

- product and process owners for the corporation tax reliefs in our sample and for venture capital trusts had developed detailed plans setting out specific risks to the reliefs and timetables for stakeholder engagement. In this area product and process owners have responsibility for a single relief or group of closely related reliefs; and
- the product plan for the personal tax reliefs in our sample was focused on the strategic direction of capital gains tax as a whole. While it refers to principal private residence relief and entrepreneurs' relief, it is not intended as a plan for how to manage them; for instance, the risks listed are for the wider tax stream and do not include those specific to entrepreneurs' relief.

3.16 There may be good reasons for differences between plans, but the teams responsible could not explain them. We saw no evidence that product and process owners were intending to manage reliefs differently as a result of the guidance. We recognise that product and process owners may still be considering how to use the new guidance and that HMRC has not made it clear to product and process owners that it is compulsory. We would expect to see a more consistent application of the guidance emerge over the next 12 months, including the systematic listing of reliefs by each product and process owner.

3.17 We support HMRC's intention to make clear that the new guidance is compulsory for all product and process owners who administer tax reliefs. In particular, we consider it important that teams should compile a comprehensive list of those reliefs for which they have responsibility. Product and process owners should risk-assess their reliefs to help decide what administrative set-up and level of oversight is necessary. This assessment should also decide which aspects of good practice are most applicable to the reliefs they manage.

3.18 We found examples of good practice in how teams promote corporation tax reliefs and collect feedback on their use. HMRC has a detailed stakeholder engagement plan for patent box setting out how it intends to raise awareness among relevant companies, such as by attending trade fairs. Teams responsible for high-end TV relief and venture capital schemes regularly meet with stakeholders to hear how the reliefs have affected claimants' business decisions.

3.19 We identified good practice in monitoring cost trends, particularly where specialist units manage reliefs (**Figure 16** on pages R52 and R53). Specialist units for patent box, creative industry reliefs (including high-end TV) and venture capital schemes (including venture capital trusts) check all claims, or applications, giving them a good understanding of the movements in costs over time. HMRC responded quickly, proposing policy changes, after variations in the cost of venture capital trust reliefs alerted it to investments which did not meet the reliefs' objectives.

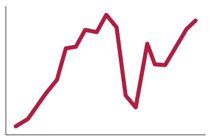
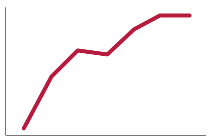
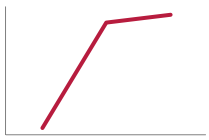
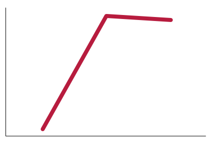
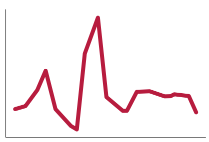
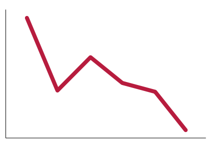
3.20 In previous reports, we raised concerns that entrepreneurs' relief was costing three times more than expected.[39] Since our last report, the government has introduced legislation to tackle specific areas of risk to entrepreneurs' relief, such as joint venture structures. It expected these changes to reduce the annual cost of the relief by £200 million by 2019-20. However, claimants complained the changes went too far, denying legitimate use of the relief to some taxpayers. The restrictions were partially reversed in 2016, including allowing taxpayers to claim the relief for joint ventures.

3.21 HMRC has limited independent evidence of how taxpayers are using entrepreneurs' relief, but is seeking to address this. Qualitative research it commissioned identified few cases where the relief had incentivised taxpayers to invest, but there was some evidence that entrepreneurs' relief was seen as a reward for investment and that it affected the timing of decisions. It was a qualitative study and was never intended to be statistically representative, being based on the opinions of 17 claimants and 11 tax agents. HMRC is planning a more extensive review in 2016-17, involving 1,700 claimants, taxpayers who may be eligible for the relief but do not claim it, and tax agents. But the evaluation results will only be available eight years after introducing the relief.

3.22 HMRC has various methods it can use in real-time to keep track of the cost of new reliefs in the corporation tax area. For example, we previously reported that patent box had made use of new techniques to manage the risk of unintended use and unexpected cost. These included reviewing claims for the relief by searching for key words and undertaking population-based analysis of claims at the end of the first full tax year. HMRC should consider whether such measures could be recommended in its guidance as examples of good practice for new reliefs.

39 See paragraphs 2.11 to 2.16 of Comptroller and Auditor General, *The effective administration of tax reliefs*, Session 2014-15, HC 785, National Audit Office, November 2014.

Figure 16
Monitoring cost trends

Tax relief (Forecast cost in 2015-16)	Trend	Policy owner's explanation
Principal private residence relief (£18 billion)	 1997-98 to 2015-16	Costs not monitored by policy team.
Entrepreneurs' relief (£3 billion)	 2008-09 to 2015-16	The increase in the cost is largely the result of equity price movements.
Patent box (£675 million)	 2013-14 to 2015-16	As this is a new relief there is a lack of steady-state data with which to compare current levels.
High-end TV tax relief (£120 million)	 2013-14 to 2015-16	Cost is much higher than forecast. The product owner attributes this to higher than expected take-up, rather than abuse.
Venture capital trusts (£80 million)	 1997-98 to 2015-16	The spike related to increased investments in low-risk sectors. The forecast drop for 2015-16 reflects recent restrictions.
Interest on qualifying loans (Not known. NAO estimate £170 million in 2013-14)	 2008-09 to 2013-14	Low interest rates and curbing abuse reducing the number and scale of claims.

Notes

1 Cost data taken from HMRC's annual publication on tax reliefs, except for tax relief for interest on qualifying loans.

2 We estimated the cost of tax relief for interest on qualifying loans using unpublished data provided by HMRC. We used interest deducted on tax reliefs and the number of claimants in each income band in 2011 (to estimate the tax rate to apply).

Source: National Audit Office analysis of HM Revenue & Customs data

Source of assurance	National Audit Office (NAO) assessment of relative quality of monitoring	Good-practice examples
Costs are estimated by the statistics team but trends are not monitored by policy team because estimates are based on house price trends, not tax returns.	Weak.	
None, costs are estimated by the statistics team but are not monitored by product owners on the grounds that costs simply reflect changes in asset prices.	Needs improvement.	An evaluation of the relief is planned.
Monthly discussions between product owner and specialist teams. Claims are checked and guidance reviewed for clarity, completeness and correctness.	Strong.	Involvement of specialist unit Engagement with stakeholders: publicising and explaining the relief and changes at trade fairs.
100% checking of claims and the cost is monitored by specialist units.	Strong.	Involvement of specialist unit Engagement with stakeholders to understand industry.
Cost of relief monitored by specialist unit but further investigation limited by poor data. Until data is digitised, HMRC relies on discussions with stakeholders.	Needs improvement.	Engagement with stakeholders: ongoing dialogue about whether potential investments qualify for relief. Recommended changes to legislation to exclude activities where relief no longer appropriate.
Total amount of interest deduction are collated by statistics team but amounts not compared over time.	Needs improvement.	Estimate the tax at risk. Included in the cap on income tax relief as a result of concerns about abuse.

Ensuring tax reliefs are managed proportionately

3.23 The sheer number of tax reliefs means it would be impractical for HMRC to administer each individually, and in many cases the costs of doing so could outweigh the benefits. HMRC manages reliefs as part of the wider tax system. It recognises that it must take a risk-based approach to manage reliefs proportionately, considering their cost and expected impact. HMRC's new guidance has focused on setting up arrangements for new tax reliefs. These tend to carry greater uncertainty and risk. But older tax reliefs can present risks too; changing trends can lead to increased take-up or they can become the focus of tax avoidance schemes. Long-standing reliefs such as share loss relief have been targeted by tax avoidance schemes in the past. Within our sample, we have also seen attempts to use qualifying loan interest relief to avoid tax.

3.24 HMRC's guidance does not help product and process owners determine which reliefs need closer oversight. This means decisions on how best to assign resources may be inconsistent. Within our sample of reliefs we looked for evidence that the information collected about reliefs is proportionate. We noted little oversight for capital gains tax reliefs, despite their significant values (**Figure 17**). We understand this largely reflects HMRC's approach to the wider regime. At £7.3 billion, capital gains tax revenue is relatively small, around 1% of total UK tax take. However, the amount of tax relief is at least three times the value of capital gains tax, with private residence relief estimated at £18 billion, and entrepreneurs' relief estimated at £3 billion in 2015-16. HMRC does not consider the cost of private residence relief to be a good indicator of the level of oversight needed because few homes fall within the scope of capital gains tax.

3.25 There is little oversight of principal private residence relief by policy teams. The relief exempts gains on individuals' main homes from capital gains tax. Individuals do not have to claim it, so HMRC cannot directly monitor its cost. HMRC estimates the cost of the relief using external data. It uses survey data to assess whether sufficient numbers of self-assessment returns have been submitted, but this data does not allow precise reconciliation. HMRC is reluctant to introduce comprehensive reporting requirements for all house sales because this would place a burden on taxpayers and its administration. Its compliance checks mainly focus on those already submitting self-assessment returns, and it has recently introduced a tick-box in order to identify claimants using principal private residence relief. HMRC also runs annual checks using third party data to identify high-risk cases and uses occasional campaigns to recover unpaid tax (for example, by prompting voluntary disclosures). These to date have yielded relatively little additional tax. HMRC believes that although principal private residence relief is a high-value relief, it is low-risk. By contrast, HMRC invests more in checking some smaller reliefs such as high-end TV tax relief. Worth just £120 million in 2015-16, a specialist unit checks every single claim.

Figure 17

The value of reliefs and the level of oversight

	Cost	Objectives	Administrative data			Costs		Risk of abuse		
	Cost in 2015-16	Objectives known	Cost of administering relief is known	Number of staff administering relief is known	Proportion of claims checked is known	Cost of tax relief is known or estimated	Cost of relief is forecast	Cost of abuse estimated	Value of tax at risk estimated	Success rate in investigations known
Private residence relief	£18bn	✔	✗	✗	✗	✔	Partly	✗	✗	✗
Entrepreneurs' relief	£3bn	✔	✗	✗	✗	✔	Partly	✗	✗	✗
Patent Box	£675m	✔	✔	✔	✔	✔	✔	✗	✗	✔
High-end TV relief	£120m	✔	✔	✔	✔	✔	✔	✗	✗	✗
Venture Capital Trusts	£80m	✔	Partly	Partly	✗	✔	Partly	✗	✗	✗
Interest on qualifying loans	£170m	✔	✗	✗	✗	✗	✗	Partly	Partly	Partly

Note

1 The cost of interest relief on qualifying loans is not known. We estimate it cost £170 million in 2013-14.

2 We asked each of the policy teams responsible for managing our sample tax reliefs whether they knew the success rate of investigations relevant to their reliefs. For most teams, this data was not readily accessible nor regularly monitored. HMRC told us that operational teams monitor compliance in different ways. HMRC tracks compliance cases for high-end TV separately, and uses wider compliance checks and campaigns for self-assessment returns, covering entrepreneurs' relief and principal private residence relief. For venture capital reliefs, HMRC relies instead on a prevention strategy.

Source: National Audit Office analysis of HM Revenue & Customs data

3.26 Given the scale of principal private residence relief, complexity of the rules and lack of reporting requirements, there is scope for wide-scale misuse to go undetected. The number of buy-to-let landlords has risen significantly in recent years. Eligibility for principal private residence relief is not always straightforward. There are several restrictions and related reliefs which allow individuals to claim relief for two homes concurrently. This means more scrutiny may be needed to ensure people are following the rules correctly.

3.27 In 2014, we commissioned the Tax Administration Research Centre (TARC) to help us to think more systematically about the risks presented by tax reliefs. TARC identified nine risks to tax reliefs.[40] For the reliefs in our sample, we focused on five risks about monitoring and evaluation of reliefs. We considered the extent to which the teams managing the reliefs had addressed each of these risks and identified varying degrees of mitigation (**Figure 18** on pages R58 and R59). We found HMRC mitigates risks well for high-end TV relief, patent box relief and venture capital trusts.

3.28 Awareness of the level of risk relevant to a particular relief should drive the amount of oversight it receives. Using a framework like this could help HMRC ensure it is managing its reliefs proportionately to the risks they present. HMRC may sometimes regard the risks as low in likelihood or unmanageable. But without guidance on factors to consider, there is scope for risks to be overlooked altogether, especially given pressure to reduce running costs.

Improving the reporting of tax reliefs

3.29 HMRC has committed to improving its reporting on tax reliefs. In response to the Committee of Public Accounts' recommendations it expanded its December 2015 publication on the cost of tax reliefs to cover four years, allowing more visibility of how costs changed over time.[41] Otherwise, HMRC has not significantly changed the scope or depth of its reporting. In response to the Committee's recommendations, HMRC agreed to publish monitoring information and explain changes to estimates and costs over time for around 180 reliefs.[42] HMRC has told us it has no plans to further improve its reporting.

3.30 HMRC's recent publication on tax reliefs did explain some cost changes, but this was not consistent or proportionate. It only included cursory commentary on cost changes for a minority of reliefs. HMRC explained a forecast £60 million drop in income tax relief for venture capital trusts, but not a £1.7 billion increase in principal private residence relief between 2014-15 and 2015-16.

40 We published the Tax Administration Research Centre's report as a technical paper alongside Comptroller and Auditor General, *Tax reliefs*, Session 2013-14, HC 1256, National Audit Office, April 2014. It is available at the following address: www.nao.org.uk/report/tax-reliefs-3/

41 HM Treasury, *Treasury Minutes: Government responses on the Thirtieth, the Thirty-fifth, the Thirty-seventh, and the Forty-first to the Fifty-third reports from the Committee of Public Accounts: Session 2014-15*, July 2015. See recommendation 3 of the Forty-ninth report.

42 See footnote 36.

3.31 While the number of reliefs has increased over time, the number HMRC reports on has stayed roughly the same. The Office of Tax Simplification listed more than 1,100 reliefs in force as at March 2015, whereas HMRC's publication had 392 in 2015-16, of which 174 had a cost estimate. HMRC's approach is to report in its annual publication the costs of all tax reliefs for which reliable data are available. It has not sought to increase the number of reliefs for which it collects cost data on the grounds that doing so would impose an administrative burden on taxpayers and HMRC. We could not find evidence that HMRC had weighed the costs and benefits of collecting and publishing such data. HMRC told us that it publishes data where these are available but some are dispersed in other publications. This includes certain large reliefs, such as group relief from corporation tax, which is published in annual statistics on corporation tax.

3.32 HMRC considers that it identifies the main tax expenditures in its annual publication of costs. Although it provides a loose definition for tax expenditures in its publication, HMRC has told the Committee of Public Accounts it does not recognise tax expenditures as a separate class of tax relief. Some of the reliefs it has listed as tax expenditures do not have a clear policy objective.

3.33 We also identified information which is published by HMRC separately from its annual publication of tax reliefs. For example, information about the estimated cost of some corporation tax reliefs is published elsewhere, as is research commissioned by HMRC to understand more about how certain reliefs are working. It would help Parliament and the public to understand more about the costs and benefits of reliefs if HMRC were to publish all this information in a more accessible way, for example expanding its annual publication to include links to relevant documents. Without knowing that an evaluation of a particular relief has been undertaken or where to look, it is currently very difficult for a member of the public to find such information.

Figure 18

Risks affecting tax reliefs and the level of mitigation observed in our review

The effectiveness with which risks are mitigated varies across reliefs

Risks affecting tax reliefs	Principal private residence relief	Entrepreneurs' relief	Patent Box
The relief does not deliver policy objective	n/a	Quantitative research on investment motivations is planned	Engagement with stakeholders to understand its use
The relief costs more than anticipated to administer	Minimal administration to avoid burden on taxpayers	Self-assessment process enables low-cost administration for compliant claimants	Dedicated unit with known costs to administer relief has strategy for helping claimants claim correctly
The relief is not taken up by intended beneficiaries	Taxpayers automatically receive relief and only declare when not eligible for relief	Typically, beneficiaries learn about this relief through their tax advisers	Stakeholder engagement plan to help right beneficiaries claim relief
The relief results in greater loss of revenue than anticipated	Costing model produces forecasts	Costs exceed budget forecasts. Limited investigation of the reasons so far but large-scale quantitative research is planned	Baseline cost available from tax information and impact notes
The relief is subject to abuse resulting in lost revenues	Compliance checks on self assessment returns. No systematic checks where individuals do not submit returns. HMRC uses campaigns to recover unpaid tax	Monitoring of £10 million lifetime limit by HMRC s dedicated High Net Worth Unit	Dedicated unit checks all claims. Risks discussed regularly between product owner and specialist unit

- No mitigation: No evidence that the risk is being mitigated
- Limited mitigation: Some controls are in place, but these are not sufficient to mitigate the risk
- Some mitigation: Controls are in place that partly mitigate the risk
- Good mitigation: Comprehensive controls are in place to mitigate the risk
- Not applicable

Note

1 Risks identified in a technical paper by the Tax Administration Research Centre published alongside our *Tax Reliefs* report.

Source: National Audit Office analysis of HM Revenue & Customs data using Tax Administration Research Centre risks

High-end TV tax relief	Venture Capital Trusts (VCTs)	Relief for qualifying loans interest
Engagement with stakeholders to understand its use	Engagement with stakeholders to understand its use. Thorough evaluation planned for 2019	n/a
Dedicated unit with known costs to administer relief identifies claimants who need most help	Dedicated unit to administer relief and run helpline for VCTs, but not individual investors	Self-assessment process enables low-cost administration for compliant claimants
Close engagement with production companies to promote the relief	Close relationship with VCT industry including to promote the relief, but not with individual investors	Guidance and prompts in tax returns raise awareness for self assessment customers. No promotion to target group because HMRC believes they are already aware of the relief
Baseline cost available from tax information and impact notes Forecast cost model available	Risk register demonstrates active awareness of unintended use of relief HMRC responded effectively to spikes in costs by changing legislation	The actual cost of the relief is not calculated or monitored
Dedicated unit checks all claims and maintains risk register	HMRC uses industry links to inform risk assessment and believes the VCT community is largely compliant	Abuse has been detected and action is being taken to challenge two large scheme users in the courts

Part Four

Benefits and credits

4.1 HM Revenue & Customs (HMRC) administers Personal Tax Credits and Child Benefit to support families with children and to help ensure that work pays more than welfare. In 2015-16 HMRC spent £39.9 billion on benefits and credits. Of this, £28.2 billion was spent on Personal Tax Credits and £11.7 billion was Child Benefit. Personal Tax Credits supported around 4.4 million families and around 7.4 million children. It represented 49% of total expenditure of £57 billion recorded in HMRC's 2015-16 Resource Accounts. Child Benefit supported around 13.2 million children, and represented 20.5% of expenditure.

4.2 This Part of our report covers:

- the qualification of the Comptroller and Auditor General's (C&AG's) opinion on the Resource Account due to irregular expenditure in Personal Tax Credits;
- the estimated level of error and fraud in Personal Tax Credits, including analysis of these losses by risk area;
- how HMRC is reducing error and fraud in Personal Tax Credits;
- the migration of Personal Tax Credits to Universal Credit; and
- error and fraud in Child Benefit.

Personal Tax Credits

4.3 Personal Tax Credits were introduced in April 2003. They aim to support families with children; tackle child poverty; and help to make sure that work pays more than welfare. The government is continuing to roll out Universal Credit. This will replace many of the current working-age benefits, including Personal Tax Credits, with a single means-tested payment. HMRC will be responsible for administering the Personal Tax Credits scheme until all existing customers have transitioned to Universal Credit. This is expected to be in 2021.

4.4 Personal Tax Credits are complex and rely on customers notifying HMRC of changes in their circumstances that affect their eligibility. Tax credits are awarded on an annual basis. HMRC makes a provisional award based on the information it holds. It makes in-year payments based on estimated figures and then calculates the final amount after the end of the year, once actual household income and circumstances are known. These complexities within Personal Tax Credits present challenges for HMRC when administering awards. They mean that overpayments and underpayments are part of the way the system works.

Qualification of the C&AG's audit opinion on the regularity of Personal Tax Credits expenditure

4.5 Under the Government Resources and Accounts Act 2000, the C&AG must obtain enough evidence to give reasonable assurance that:

- the expenditure and income recorded in the financial statements have been applied for the purposes intended by Parliament; and
- the financial transactions recorded in the financial statements conform to the authorities that govern them (the C&AG's regularity opinion).

4.6 The Tax Credits Act 2002 specifies the eligibility criteria for Personal Tax Credits and the method HMRC should use to calculate the amounts to be paid. Where error and fraud result in overpayment or underpayment of benefit to an individual who is either not entitled to that benefit or is paid at a different rate from that specified in the legislation, the transaction does not conform with Parliament's intention and is irregular. In respect of HMRC's 2015-16 financial statements, the C&AG has qualified his opinion on regularity due to the material level of estimated error and fraud in Personal Tax Credit expenditure.

4.7 This is the fifth consecutive year in which HMRC's Resource Accounts have been qualified for irregular Personal Tax Credits expenditure. Between 2003-04, when the scheme started, and 2010-11, Personal Tax Credits were reported in HMRC's Trust Statement. The Trust Statement was qualified throughout this period. As a result, the C&AG has reported to Parliament on Personal Tax Credits every year since they were introduced.

Estimated level of error and fraud in Personal Tax Credits

4.8 HMRC's best estimate of the level of error and fraud in Personal Tax Credits for 2015-16 relates to error and fraud in 2014-15. This is because awards for 2015-16 have not yet been finalised, in accordance with the normal tax credits annual cycle. Finalisation of awards occurs between April and July following the end of the tax year or the following January for self-assessment customers. Following finalisation, testing is undertaken to inform the estimate of error and fraud.

4.9 HMRC estimates[43] that the overall level of error and fraud that resulted in overpayments[44] in Personal Tax Credits in 2014-15 increased to 4.8%[45] of total Personal Tax Credits expenditure (from 4.7% (restated) in 2013-14). HMRC estimates that the overall level of error resulting in underpayments in Personal Tax Credits in 2014-15 remained stable at 0.7% of total Personal Tax Credits expenditure (from 0.7% (restated) in 2013-14). This equates to overpayments of £1.37 billion and underpayments of £0.19 billion.

4.10 HMRC has restated 2013-14 overpayments from 4.4% to 4.7% and 2013-14 underpayments from 0.6% to 0.7%. HMRC attributes all of the 2013-14 restatement to factors within the normal cycle of Personal Tax Credits. This includes time taken for appeals, and the need to project the outcome of cases that were not closed at the time the estimate was produced.

4.11 As there is no more recent and sufficiently reliable evidence to estimate the level of overpayments and underpayments attributable to error and fraud, the estimate for 2014-15 is the best indication of error and fraud in Personal Tax Credits expenditure for 2015-16.

Personal Tax Credits error and fraud by risk area

4.12 The rate of error and fraud resulting in overpayments has fallen considerably since 2010-11 (**Figure 19**). This followed HMRC's change in strategy in 2009 to move its focus from compliance interventions that were largely designed to identify error and fraud after claims had entered the system ('pay now, check later') to interventions that were increasingly designed to prevent error and fraud from entering the system ('check first, then pay' approach). At the same time it restructured its approach to significantly increase the number of error and fraud interventions. HMRC has maintained this approach, but from 2012 it has also:

- increased capacity by using a private sector contractor;
- changed policy to reduce the risk of error and fraud in the process of administering Personal Tax Credits; and
- considered how it could best support customers, for example through assisting claimants accurately reporting childcare information while on the phone.

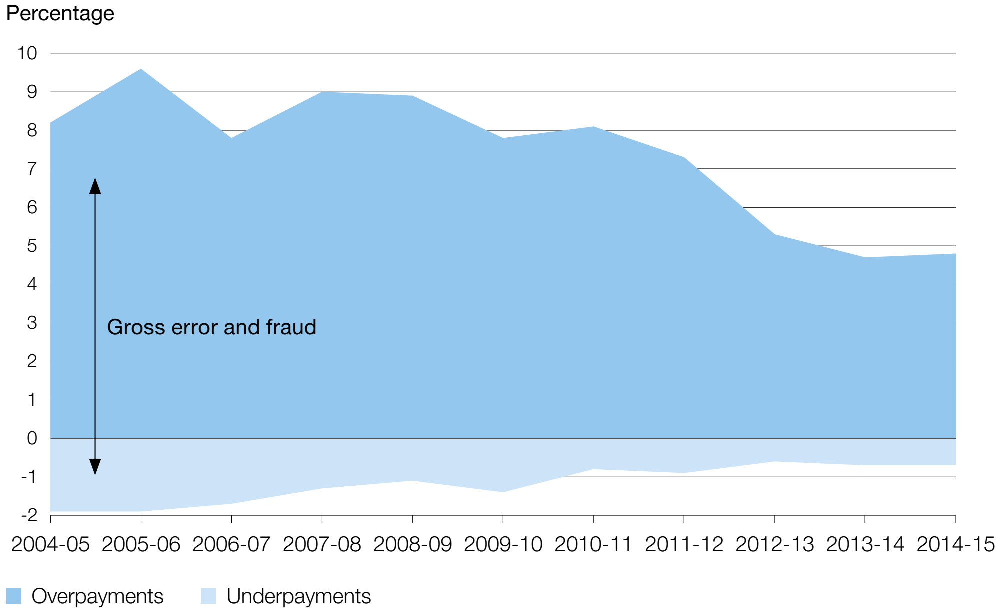
4.13 A key factor in HMRC's 2009 change in approach was the disaggregation, by risk type, of losses from overpayments in order to identify underlying causes of error. HMRC analyses the level of error and fraud resulting in overpayments of Personal Tax Credits against six main causes of loss.

43 Note 4.3 to the Resource Accounts.
44 HM Revenue & Customs' published statistics refer to error and fraud resulting in overpayments as error and fraud favouring the claimant and error resulting in underpayments as error favouring HM Revenue & Customs.
45 Error and fraud figures quoted within the main body of this chapter are central estimates within a 95% confidence interval. This range reflects the uncertainty within the estimates. Detail on the estimate ranges are provided within the table in Figure 19.

Figure 19

HMRC's Personal Tax Credits overpayment and underpayment estimates from 2004-05 to 2014-15

Overpayments and underpayments by percentage of total Personal Tax Credits expenditure



EFAP year	Error and fraud as a percentage of finalised entitlement					
	Overpayments			Underpayments		
	Lower bound (%)	Central estimate (%)	Upper bound (%)	Lower bound (%)	Central estimate (%)	Upper bound (%)
2004-05	7.3	8.2	9.1	1.4	1.9	2.4
2005-06	8.5	9.6	10.6	1.4	1.9	2.4
2006-07	7.2	7.8	8.4	1.3	1.7	2.1
2007-08	8.3	9.0	9.7	1.0	1.3	1.6
2008-09	8.3	8.9	9.6	0.8	1.1	1.3
2009-10	7.0	7.8	8.6	0.9	1.4	2.0
2010-11	7.5	8.1	8.8	0.6	0.8	1.0
2011-12	6.6	7.3	7.9	0.6	0.9	1.2
2012-13	4.7	5.3	6.0	0.4	0.6	0.9
2013-14	4.2	4.7	5.2	0.6	0.7	0.9
2014-15	4.4	4.8	5.2	0.6	0.7	0.8

Notes

1 HMRC has set a new target for 2016-17 to keep error and fraud resulting in overpayments no higher than 5% of Personal Tax Credit spend.

2 HMRC has not set a target for reducing underpayments.

3 The 2013-14 error and fraud overpayment statistics have been restated by 0.3% to 4.7%.

4 The 2013-14 error and fraud underpayment statistics have been restated by 0.1% to 0.7%.

Source: HM Revenue & Customs Child and Working Tax Credits Annual Error and Fraud Statistics 2014-15

4.14 **Figure 20** shows HMRC's progress in reducing error and fraud losses against each of these factors since it introduced its new approach. HMRC has used this insight to restructure and target its range of intervention activities across the major risk areas. This is to both prevent and detect error and fraud, although the impact of more recent changes will not yet be reflected in the most recent error and fraud estimates.

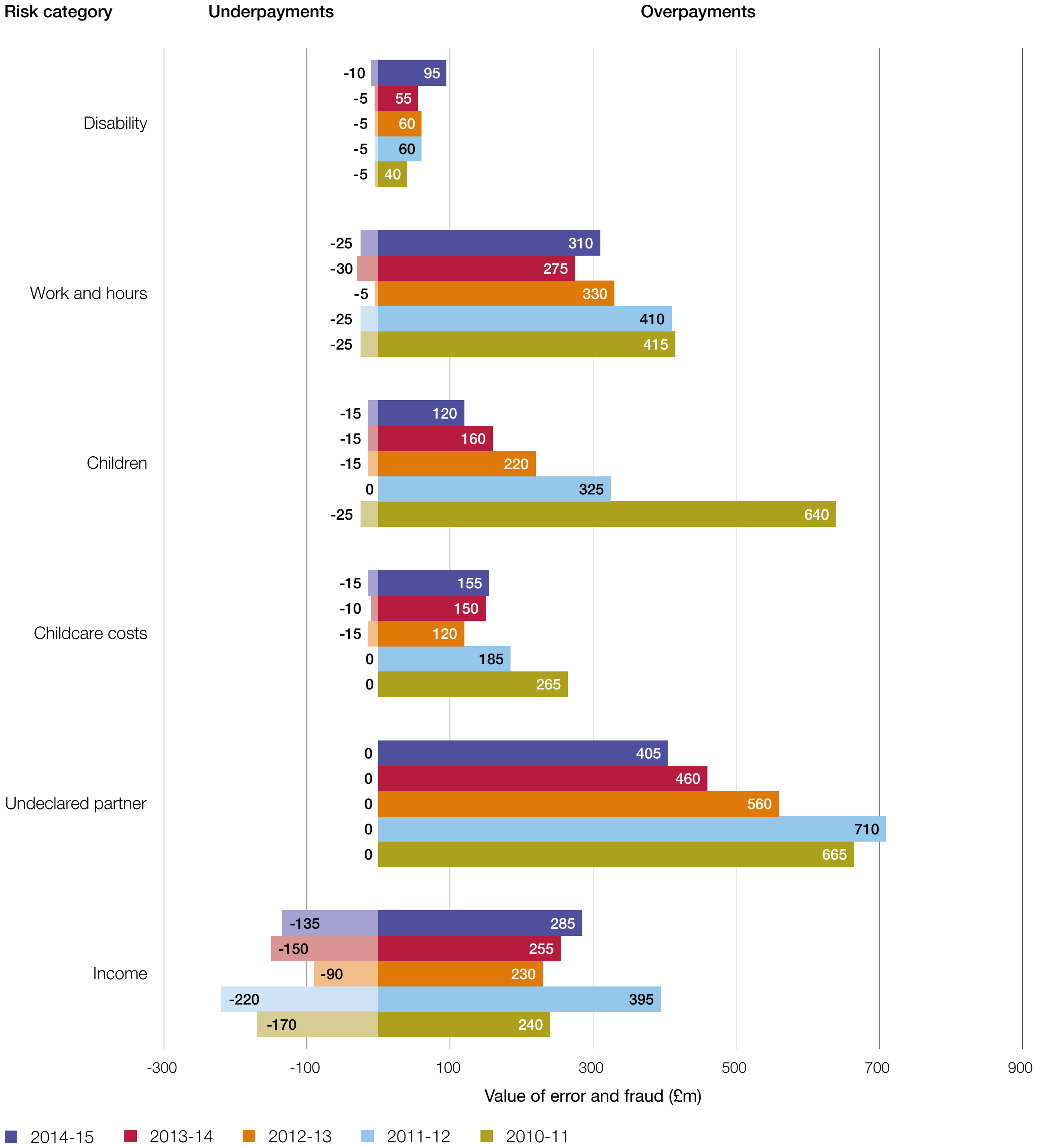
4.15 HMRC carries out an annual analysis in which it breaks down the main causes of error and fraud within each of the main risk areas. As Figure 20 shows, HMRC's initial assessment of the small increase in the total level of error and fraud in 2014-15 is an increase in the losses attributable to errors relating to income, hours worked and disability status risk categories. HMRC's analysis also shows the downward trend in losses attributable to errors in the undeclared partner risk category, following the introduction of checks using credit reference agency data, and the children risk category, as measures have been taken to combat the incorrect reporting of the full-time non-advanced education status of young people. HMRC also analyses the point at which the error and fraud enters the system; whether at the point of a new claim, a change of circumstances or on renewal. This analysis is deepened from time to time by new initiatives focusing on specific risks, such as its recent initiative to tackle the risks related to the low-income self-employed. This analysis is important in identifying options to further reduce error and fraud, to prioritise the most effective interventions and to inform a view of what level of loss reduction may be possible.

4.16 The rate of underpayments has remained the same since 2013-14. HMRC has not analysed underpayments in detail, although the evidence suggests that these are mainly due to errors relating to income.

4.17 Since 2009, HMRC has introduced several interventions and activities designed to address error and fraud at a risk level. **Figure 21** on page R66 gives examples of the interventions and activities HMRC has implemented to address error and fraud within Personal Tax Credits at a risk level. To tackle error and fraud, HMRC uses interventions targeted at specific risk categories, and separate interventions that address multiple risks.

Figure 20

HMRC's Personal Tax Credits overpayment estimates by risk type for 2010-11 to 2014-15



Notes

1 The 2013-14 error and fraud overpayment statistics have been restated by 0.3% to 4.7%.

2 The 2013-14 error and fraud underpayment statistics have been restated by 0.1% to 0.7%.

Source: HM Revenue & Customs, Child and Working Tax Credits Annual Error and Fraud Statistics, 2010-11 to 2014-15

Figure 21

Examples of HMRC's interventions and activities to address error and fraud at a risk level

Risk area	Estimated loss 2014-15 (£m)	(%)	HMRC's interventions by Risk Type (Single)
Undeclared partner Arises when a joint claim should have been made instead of a single claim	405	29.6	HMRC works with a credit reference agency to identify whether a single claimant has financial connections with another adult.
Income Arises when not all income is reported at finalisation	285	20.8	Exploiting data from Real Time Information (RTI) to identify changes in customers' income.
Work and hours Arises when claimants claim to be working more than they were	310	22.6	HMRC uses DWP information to identify claimants who have recently moved in and out of work, and on to benefits. Self-employed customers are required to demonstrate that they are operating on a commercial and profitable basis to claim Working Tax Credits.
Childcare costs Arises when incorrect costs are claimed for	155	11.3	Verifying registered childcare providers through accessing third-party data.
Children Arises when children or young people are incorrectly included on a claim	120	8.8	HMRC requires claimants to provide a declaration on education status of children aged between 16 and 19. It also sends letters to parents of 18-year-olds asking whether they remained in full-time education, amending the award if they fail to comply. HMRC also identifies discrepancies between claimants' tax credits and child benefit data.
Disability Arises when disability status is incorrectly reported	95	6.9	HMRC uses DWP data to identify customers incorrectly claiming the disability element of tax credits.
HMRC's interventions by risk type (multi)			A number of HMRC's interventions target more than one risk category on a personal tax credits claim: • Profiling detects claims on which a change of circumstance has not been reported, over a period of time in which it would have been expected to have occurred, with the customer being contacted to provide evidence. • Identifying claims with the most risk attached to them and requiring the customer to contact HMRC to confirm and update information before their claim can be renewed (low-risk cases are auto-renewed unless the customer has notified HMRC of a change). • Assessing the risk of new applications before processing, to highlight potentially erroneous or fraudulent income and work and hours information, and comparing this to data held on HMRC systems. • Exploiting HMRC data (from RTI and Connect) and DWP data to identify undeclared or understated income. • Providing interactive guidance for contact centre staff to help claimants calculate childcare costs, and prompt advisers to ask specific questions based on the information provided by customers.

Source: National Audit Office interpretation of HM Revenue & Customs' Logical plan 2015-16

HMRC's progress in reducing error and fraud within Personal Tax Credits

4.18 Our report *Fraud and error stocktake* reviewed the progress made by HMRC and the Department for Work & Pensions (DWP) in reducing error and fraud in Personal Tax Credits and welfare benefits.[46] The report concluded that HMRC's success in reducing error and fraud was encouraging. It suggested that HMRC's initiatives and a more structured approach were tackling overpayments effectively. The departments needed to build on recent efforts to develop a more integrated and systematic response to preventing error and fraud, and to track the impact of initiatives through to outcomes to achieve sustained and continuing reductions in error and fraud.

4.19 We identified the critical factors to assess the departments' responses to error and fraud. Starting with clear strategies at a benefit level based on an understanding of the causes of error and fraud, supported by appropriate governance, controls and interventions to reduce error and fraud can be designed into the framework for the credit or benefit, effectively implemented, and the impact evaluated. We believe that, over time, this understanding of the causes of error and fraud, with the evaluation of the efficacy of controls and interventions by benefit and cause of loss, will allow departments to identify a lowest feasible level of error and fraud by benefit.

4.20 Since we reported in 2015, HMRC has continued its efforts to tackle error and fraud. We have reviewed HMRC's response to reducing error and fraud, considering the strategy, design, implementation and evaluation of error and fraud activities (**Figure 22** overleaf).

4.21 As discussed in paragraphs 4.12 and 4.13, since 2009 HMRC has changed its approach to addressing error and fraud within Personal Tax Credits. HMRC has set a new target for 2016-17, up until all customers have moved to Universal Credit, to keep the level of error and fraud overpayments to a level no higher than 5%. When setting this target, HMRC has identified the main factor as the impact of the migration to Universal Credit, although it also takes account of a level of uncertainty in the impact of future policy changes on error and fraud. HMRC has not set a target for reducing error due to underpayments of Personal Tax Credits that, in 2014-15, are estimated to be 0.7% of finalised entitlement or £190 million.

4.22 HMRC aims to ensure customers understand what is required of them when making claims and that they act accordingly (Figure 22). HMRC aims to ensure contact with customers minimises disruption to awards, while being proportionate to the potential risk in each claim. Although the volume of interventions has increased through the Error and Fraud Adding Capacity (EFAC) project, HMRC ensures its private sector business partner, Concentrix, operates processes that mirror its own and are held to the specific service standards set out in the contract.

46 Comptroller and Auditor General, *Fraud and error stocktake*, Session 2015-16, HC 267, National Audit Office, July 2015.

Figure 22

HMRC's response to reducing error and fraud

Establishing clear strategies and governance	**HMRC's error and fraud strategy** – The business plan and operational plans are informed by the most recent error and fraud data available to the Department. In-year performance against plan is monitored through intervention volumes and yields achieved.[1] **Prevent, Detect, Promote** – increase interventions that address the prevention of error and fraud ('check first, then pay'), the detection of error and fraud already in the system, and the promotion of correct customer understanding and behaviour to minimise error and deter fraud. **Error and fraud targets** – HMRC has agreed with ministers a target to maintain error and fraud at no more than 5%. This target applies to overpayments, there is no target to limit underpayments. **Increasing the number of targeted interventions** – increasing the volume of intervention activity on awards and targeting these against awards with the highest levels of error and fraud.
Designing controls into the way departments work	**Tailoring interventions to risks** – the design and development of bespoke interventions to tackle error and fraud specific risk types across the full cycle of Personal Tax Credits. **Risk assessment and case profiling to target interventions** – design is underpinned by risk assessment (identifying characteristics that give rise to loss) and case profiling (identifying characteristics within existing cases that indicate intervention is required). **Use of data** – increased use of data-matching to support case profiling and support decision-making. HMRC is seeking to increase automated bulk data-matching with a greater number of sources.
Implementing controls and interventions effectively	**Customer support** – improving the information and support available to claimants to make it easier for them to comply with their obligations and capture changes in circumstance. **Dedicated teams** – dedicated teams to design, implement and monitor the delivery of risk-based interventions in accordance with the operational plan. Examination, and where appropriate correction, of discrepancies between the information on a Personal Tax Credits claim and other data sources. **Increase in capacity** – HMRC has increased capacity to review higher-risk cases through the use of private sector contractors under a payment by results model. The EFAC project is now expected to deliver £405 million in overall benefit.
Measuring and evaluating performance	**Operational success measures** – losses identified and prevented are measured for all interventions, including those targeted at specific risk and multi-risk interventions. This information supports the monitoring of the delivery of the operational plan and informs future planning including the prioritisation of intervention activity. **Error and fraud outcomes** – the Error and Fraud Analysis Programme (EFAP) provides an annual estimate of error and fraud losses on finalised awards, including an analysis by risk type. **Matching intervention outputs and outcomes** – the complexity of the tax credit programme makes it difficult to align the measure of 'losses prevented' (outputs) with the annual estimate of outcomes under EFAP. The inherent time-lag in producing the EFAP estimate also restricts the ability to inform planning. **Assessment of potential to reduce error and fraud** – while HMRC uses its measures to identify options to further reduce error and fraud and prioritise the most effective interventions, it has not developed a view of what level of loss reduction may be possible.

Note

1 Yield represents HMRC's quantified estimate of Personal Tax Credit award that would have been paid had intervention not taken place.

Source: National Audit Office analysis

4.23 The EFAC project has added to the volume of interventions that are undertaken to tackle error and fraud. The original planned savings in 2014-15 were not achieved and HMRC changed the arrangement with Concentrix during the year and more benefits are now being realised. Savings of £147 million were achieved in 2015-16.

4.24 Where customers are unhappy with the outcome of interventions they can challenge the decisions of HMRC and Concentrix through the same internal appeals process and, where necessary, appeal via HM Courts and Tribunal Service (HMCTS). Around 0.13% of interventions result in appeals. More than half found in favour of the customer after previously requested information was given to HMRC.

Debt and recoveries of debt within Personal Tax Credits

4.25 The total value of Personal Tax Credits debt in 2015-16, before impairment, is £7.1 billion (£6.9 billion in 2014-15). Of this, £2.9 billion (£2.9 billion in 2014-15) is considered recoverable by HMRC.[47] In the C&AG's 2014-15 report, we reported that HMRC had begun to expand its capacity to recover Personal Tax Credits debts by making more use of private sector debt collection agencies (DCAs), and updating its IT systems to deduct a proportion of the payment from the new award of a claimant identified already having a debt on a previous award. These campaigns have continued throughout 2015-16. DCA (Extending Tax Credit) recoveries have totalled £116 million (HMRC bases the benefit of this measure on recoveries collected through DCAs plus recoveries collected by HMRC staff redeployed as a result of the use of DCAs). Recoveries through ongoing awards were £106 million. These two campaigns have contributed towards the total 2015-16 recoveries of £1.372 billion, some £314 million above HMRC's target. The transfer of customers, and any associated debt, to Universal Credit is discussed in paragraph 4.27.

Migration of Personal Tax Credits to Universal Credit

4.26 Under current plans, Universal Credit will fully replace Personal Tax Credits by 2021. New Personal Tax Credit applications will be replaced by Universal Credit applications in line with the DWP's Universal Credit migration timetable. HMRC ended some 33,000 claims by March 2016, as customers moved to Universal Credit. HMRC will continue to be responsible for administering Personal Tax Credits until all customers have moved to Universal Credit. Personal Tax Credits claims are expected to begin to fall significantly from October 2016 as claims are closed on a geographical basis. There will be no renewals of Personal Tax Credits after March 2021. Under current forecasts, HMRC expects 105,000 customers to move to Universal Credit in 2016-17. The migration of customers to Universal Credit will also result in a reduction of staff within HMRC, in line with the phased migration timetable, through to 2021.

47 Note 4.2 of the HMRC Resource Accounts 2015-16.

4.27 HMRC faces significant challenges as Personal Tax Credit customers move to Universal Credit. These challenges include, but are not limited to:

- uncertainty about the timing of customers transferring to Universal Credit;
- the need to finalise Personal Tax Credit claims during the year;
- developing and maintaining appropriate methods to measure error and fraud as the level of Personal Tax Credit claims falls;
- management of a caseload with more complex cases as those customers with cases that are more straightforward transfer to Universal Credit earlier; and
- ensuring that sufficient resources remain to intervene to prevent error and fraud in Personal Tax Credits in a cost-effective way.

4.28 HMRC's benefits and credits business plan sets the strategic direction for Personal Tax Credits in their current form. However, this plan and the underlying operational plans do not address all of the uncertainties that come with moving customers to Universal Credit. HMRC is now in the process of producing a comprehensive five-year strategy covering business-as-usual and the approach to, and uncertainties in, the move to Universal Credit. This will give it the opportunity to state what reductions in losses are achievable.

4.29 HMRC is working closely with DWP to agree how to recover Personal Tax Credit debt as customers move to Universal Credit. The debt associated with the 33,000 Personal Tax Credits claims stopped had not transferred to DWP as at the end of 2015-16. This will transfer in tranches throughout 2016-17. HMRC has developed an automated process that it expects will ensure the smooth transfer of debt to DWP.

4.30 When a customer moves to Universal Credit a new case will be created for the customer and any debt accumulated on the Personal Tax Credit case will be transferred to DWP separately. Only the minimum amount of personal information necessary will be transferred to DWP for each claimant. This will allow DWP to begin recovery action on any Personal Tax Credit associated debt.

Child Benefit

4.31 Child Benefit was introduced in phases between 1977 and 1979. DWP administered payments until 31 March 2003, when responsibility transferred to HMRC. Child Benefit expenditure has been reported within the HMRC (and its predecessor, the Inland Revenue) Resource Accounts since 2003-04.

4.32 As with Personal Tax Credits, HMRC also carries out work to estimate the level of error and fraud within Child Benefit. HMRC estimated that the overall level of error and fraud resulting in overpayments in Child Benefit amounted to 1.4% of total 2015-16 Child Benefit expenditure (1.5% in 2014-15) or up to £170 million (£175 million in 2014-15). Prior to 2014-15, estimates varied considerably, and methodology changed significantly from one year to another. It is therefore not possible to draw robust conclusions about trends in error and fraud in Child Benefit.

4.33 In evaluating error and fraud within Child Benefit, HMRC relies on the EFAP to produce annual estimates. A sample of ongoing Child Benefit cases are selected each year and the claimants are contacted to ask that they verify personal details and provide supporting evidence proving that the child exists, lives at the recorded address and, where the child is aged over 16, they are in full-time non-advanced education and undertaking an approved course.

4.34 The vast majority of error and fraud estimated for Child Benefit is as a result of Child Benefit customers not responding to these requests for information ('non response' cases). Without understanding the reason why customers do not respond, HMRC cannot fully understand the underlying causes of error and fraud. HMRC is contacting customers to analyse reasons why they have not responded and believes this is likely to reduce estimates of error and fraud in Child Benefit. However, this work is yet to be completed. Once completed, it will be important for HMRC to ensure that the results of this work feed into their strategy for reducing error and fraud within Child Benefit but should also inform how the estimate of error and fraud within Child Benefit can be enhanced allowing for meaningful year-on-year comparisons.

4.35 HMRC is addressing the challenge of error and fraud in Child Benefit through the re-platforming of the IT systems used in administrating the benefit and has increased compliance resources. The IT systems currently used to process Child Benefit have been in place for several decades. HMRC is due to re-platform the Child Benefit systems, with cases expected to transfer from the legacy systems to the new system, from August 2017 onwards. A new digital service project is also in progress that, once fully implemented, will allow claimants to apply for Child Benefit and notify changes in circumstance online. HMRC believes that these changes are likely to change the way that error and fraud is tackled within Child Benefit. It will also allow opportunities for a greater number of prevent and detect controls to be built into the system to improve compliance.

Appendix One

Our evidence base

1 We reached our conclusions on HM Revenue & Customs' (HMRC's) performance using evidence collected between September 2015 and June 2016.

2 For Part One, and as part of our financial audit, we reviewed the supporting information for HMRC's Trust Statement and Resource Accounts. We analysed and discussed with officials the supporting data prepared by a variety of business units within HMRC. Our analytical review examined the numbers published in the financial statements plus supporting information provided during the course of the financial audit.

3 As part of our audit of the adequacy and integrity of HMRC's revenue collection systems, we reviewed the systems for collecting revenue across all different tax streams, as well as HMRC's debt management system and the Real Time Information system introduced for PAYE.

4 Our findings on compliance yield in Part One were based on testing the controls for scoring and reporting of compliance yield, site visits to various lines of business across the three main directorates of HMRC, reviews of 74 case files (of different types – specialist and criminal investigations, counter-avoidance, business tax and personal tax), document reviews and interviews. To assess the robustness of HMRC's method of estimating yield, we considered whether the measure:

- is based on the best evidence available;
- is reported in a transparent way;
- allows comparison of HMRC's performance over time; and
- has robust processes to assure data quality.

5 As part of our assessment of how HMRC measures compliance yield, we reviewed its progress in implementing the National Audit Office's (NAO's) and the Committee of Public Accounts' previous recommendations and the disclosures in HMRC's Annual Report.

6 To provide the evidence for Part Two's consideration of HMRC's plans for transforming its tax administration, we reviewed the strategy, governance and risk management for HMRC's current portfolio of programmes and projects. We specifically examined its documentation in relation to performance, accountability and delivering change. We conducted interviews with key members of staff involved in these areas.

7 For our review of tax reliefs in Part Three, we examined HMRC's progress on implementing NAO's and the Committee of Public Accounts' previous recommendations. We reviewed HMRC's internal guidance for administering tax reliefs and interviewed the policy team members who prepared it. We chose six tax reliefs for more in-depth study. We interviewed product and process owners and analysts involved in their administration, reviewed documents that they prepared as part of their work and analysed data they held. We also drew on our previous work on tax reliefs, work carried out for us in 2014 by the Tax Administration Research Centre, and on the work of the Office of Tax Simplification to identify tax reliefs.

8 For Part Four, in addition to our financial audit work on Personal Tax Credits and Child Benefit, we reviewed HMRC's error and fraud statistics analysis and information on the performance of initiatives to reduce error and fraud in Personal Tax Credits and Child Benefit payments. We interviewed key staff and reviewed documents on HMRC's plans and strategies around tax credit debt and reviewed the performance of strategic initiatives such as the use of debt collection agencies.

9 We also reviewed:

- HMRC's internal audit reports to understand the management of risks and challenges; and
- HMRC's corporate publications on compliance performance and on measuring the tax gap.

10 We reviewed our reports and those of the Committee of Public Accounts on HMRC's performance in the past year, including reports on tackling tax fraud and customer service.

Appendix Two

HMRC's response to recommendations of the Committee of Public Accounts on fraud and error

1 Following a hearing on our fraud and error stocktake in July 2015, the Committee of Public Accounts (the Committee) made a number of recommendations to both HM Revenue & Customs (HMRC) and the Department for Work and Pensions (DWP) to address the findings of the report. Our assessment of HMRC's implementation of these recommendations is included below.

HMRC's response to the Committee's recommendations

Recommendation	Treasury Minute Response	Progress
The Committee recommended, in light of HMRC's lack of understanding of what further reductions in Personal Tax Credits error and fraud are possible, despite an encouraging recent reduction, HMRC should set regular targets for reducing error and fraud in Personal Tax Credits during the transition to Universal Credit, based on an assessment of how recent reductions were achieved for each major risk area and the level of further reductions that are achievable.	Accepted: there is a need to set a strategic and sensible plan to manage error and fraud that encapsulates the transition to Universal Credit. HMRC will consider this further and set out its plans in due course.	HMRC has set a new target for 2016-17 to keep error and fraud no higher than 5%. This target is above the central estimate of error and fraud within Personal Tax Credits for both 2014-15 (4.8%) and 2013-14 (4.7%). HMRC regards this as a realistic target given uncertainties looking ahead.
The Committee acknowledged that the likely impact of welfare reforms on error and fraud is promising, but that such reforms will not solve all the problems of tackling erroneous benefit payments. It recommended HMRC adopt a strategy to identify and minimise the key risks of error and fraud arising from implementing and operating major reforms, including setting targets for the levels of error and fraud that will arise.	Accepted: the risks of fraud and error arising from major reforms are considered during the conceptual design of new initiatives, ensuring focus is maintained during development and implementation to minimise any risks introduced.	HMRC uses its benefits and credits business plan and logical plan to provide its focus on reducing error and fraud. However, HMRC could benefit from producing a strategy that considers HMRC's response to the challenges that lie ahead as Personal Tax Credit customers transition to Universal Credit. HMRC is in the process of producing such a plan.

HMRC's response to the Committee's recommendations

Recommendation	Treasury Minute Response	Progress
The Committee noted that HMRC has made little progress in preventing error and fraud resulting in overpayments and underpayments from occurring. It made several recommendations:		
a) The Committee recommended that HMRC improves its understanding of the reasons why customers make mistakes, and uses this to develop stronger preventative measures.	**a)** Accepted: action is already taken to ensure there is a greater understanding of why claimants make mistakes. This includes HMRC's Error and Fraud Analytical Programme tracking exercise.	**a)** HMRC aims to identify the causes of customer error when designing its interventions. Developing a fuller understanding, and evaluation, of the impact of customer behaviour on error and fraud could help HMRC to further reduce error and fraud.
b) The Committee also recommended that HMRC sets targets for reducing underpayments, in order to galvanise efforts to tackle this neglected issue.	**b)** Not accepted: all fraud and error measures are designed to ensure payments are correct and the global underpayments level is stable. HMRC will continue to tackle the causes of underpayments, as part of the wider approach to ensure claimants are paid the amount that they are entitled to.	**b)** HMRC has stated that it will continue to tackle the causes of underpayments through internal quality targets to achieve 97% accuracy, but HMRC does not have a target for underpayments.
c) The Committee recommended that HMRC reports back in six months on progress it has made in relation to initiatives exploiting third-party data.	**c)** Accepted: HMRC already makes use of a large amount of data from other government departments and third parties, continually exploiting their data to identify and deliver improvements on fraud and error. HMRC will report to the Committee in six months on the progress of data initiatives.	**c)** Interventions are underpinned by detailed and informative risk assessments and profiling through enhanced data analytics, using data sourced from HMRC's own systems, and other government departments.
The Committee highlighted that HMRC has not sufficiently considered how its activities to tackle tax credits error and fraud might affect people, including more vulnerable customers. It recommended that HMRC work with the government-wide Fraud, Error and Debt Steering Group to commission an independent review of customers' experience of the tax credits process. The review should include the impact of using its private sector contractor and identify ways to reduce unnecessary burdens on people.	Not accepted: HMRC recognises the need to have regard to claimants' experience, through: • having commissioned a qualitative survey on claimants' understanding of the rules; • having investigated actions to make the process easier; • publishing an annual tax credit survey of customers, used to improve HMRC's understanding of claimants; and • reviewing its complaints, including those against the private sector contractor.	HMRC has undertaken some work to understand the impact on customers of its interventions and has used this information to inform its approach to call handling and in producing its strategy.

Source: HC Committee of Public Accounts, *Fraud and Error Stocktake*, Fourth Report of Session 2015-16, HC 394, October 2015

HM Treasury, *Treasury Minutes, Government responses on the Fourth to the Eighth reports from the Committee of Public Accounts: Session 2015-16*, Cm 9190, January 2016